SDC LTD (2)
versus
THE COMMISSIONER-GENERAL
ZIMBABWE REVENUE AUTHORITY

THE SPECIAL COURT FOR INCOME TAX APPEALS
KUDYA J
HARARE, 4, 5, 6, 7, 8, 11, 12, 13, 14, 18, 19, 21 March 2019 and 30 June 2021

Income Tax Appeal-The merits

D Erasmus &H Vorster, for the appellant
E Matinenga & D Mehta, for the respondent

KUDYA J: This judgment on the merits is a sequel to *SDC Ltd* v *Commissioner General-Zimbabwe Revenue Authority* HH 648/18, which dismissed all the preliminary points raised by the appellant in this appeal. The real questions for determination in this appeal are firstly, whether the Organisation for Economic Cooperation and Development Transfer Pricing Guidelines for Multi-National Enterprises and Tax Administrations (OECD TPGs) were applicable in Zimbabwe during the 2009 to 2012 tax years, secondly whether the respondent Commissioner lawfully applied the general anti-avoidance provision (GAAP), s 98 of the Income Tax Act *[Chapter 23:06]* against the appellant by imputing royalties for the purported intragroup use of the appellant's five locally registered trademarks and management fees on the intragroup services rendered by the senior management team of the group to the appellant; thirdly, whether she correctly computed the income tax payable and lastly, whether the imposition of a penalty in any amount was appropriate, for these tax years.

The background facts

The appellant is a local multinational public company and a major player in the hybrid seed industry that is listed on the Zimbabwe Stock Exchange (ZSE or local bourse). It controls a network of foreign based subsidiary companies in which it either owns the entire or majority shareholding. These subsidiaries are incorporated in over 15 countries in SADC, COMESA and ECOWAS and South Sudan and Egypt.

The respondent is the statutory authority charged with the responsibility of collecting taxes from all eligible tax payers in Zimbabwe. The key operatives who acted on its behalf in

the present matter were a team of field investigators who worked under the command of a case manager in charge of the compliance section of complex multinational enterprises transactions, who in turn reported to the Commissioner for Investigations and International Affairs. I will, in this judgment, impute the conduct of the investigators to the case manager.

In 2012, the case manager audited the tax affairs of SDZ (Pvt) Ltd (the appellant's flagship local subsidiary- the flagship), for the 2009 to 2012 tax years. A series of transactions covering management fees and royalties between the flagship and some of the foreign subsidiaries in the same period activated the tax review of the appellant in October 2012.[1] It was common cause that the appellant had not been submitting any tax returns for the 2009 to 2012 tax years.

The appellant and the case manager held various meetings and exchanged numerous documents, correspondence and e-mails during the course of the investigations, which culminated in the issuance of the notices of assessment on 25 November 2013. The appellant was represented by its public officer and Group Financial Director (GFD), JM, who was accompanied either by the Group Chief Executive Officer (GCEO) MN, or representatives of either of its two tax consulting firms (the consultants). The interactions between the parties, however, continued into the objection and appeal stages.

The case manager attached to the notices of assessment of 25 November 2013, schedules of his computations of the cumulative income tax due, interest and penalty at the rate of 60% in the aggregate sum of US$5 726 090.02, for the period in question.

By e-mail of 23 December 2013, the appellant objected to the notices of assessment to the Commissioner. The objection was predicated upon the application of the OECD TPGs to the jurisdictional facts in s 98 of the Income Tax Act. On 7 May 2014, the Commissioner disallowed the seven general and two specific objections raised in respect of income tax in their entirety and increased the penalty, imposed by the case manager to 100%.

She held that s 98 of the Income Tax Act was correctly invoked on the adjustments to management fees and royalties. She characterized the housing of the head office function in the flagship to be a transaction, operation or scheme (TOS), which, firstly, had the effect of either avoiding or reducing the appellant's tax liability, secondly, created abnormal rights and obligations not usually created between independent parties in comparable circumstances, thirdly, notwithstanding the purported divestiture of all operations to the flagship on 1 April

[1] E-mail of 10 October 2012 p. 105 of respondent's bundle of documents.

2005, the appellant continued to employ for its own account the senior management corps who provided management services to all the subsidiaries in compliance with the listing rules of the local bourse, and not only charged management fees at cost but further diverted them to the flagship. She regarded the failure to gross up these fees and the no-employees assertion as abnormal in both the alternative respects set out in s 98.

In regard to royalties she invoked the provisions of s 98 on the following bases. Firstly, the purported transfer of the five trademarks legally owned by the appellant to the flagship, who in turn assigned them to the Botswana subsidiary was invalid because it was done contrary to the provisions of the Trade Marks Act [*Chapter 26:04*], and by a signatory who was neither authorised to do so by the board of directors nor a member thereof. Secondly, the appellant's group research manager (GRM or the scientist) and Maize Consultant in Zimbabwe were responsible for the development and monitoring of regional trials from which royalties accrued but paid to the Botswana subsidiary in place of the appellant. She held that these researchers employed their wits, labour and intellect in or from Zimbabwe to breed the germplasm used to create the hybrid seed developed and registered in the territories in which the subsidiaries were based.

In regards to the OECD TPGs, she held that they were not legislated and were therefore ineligible for use in Zimbabwe. She regarded the royalty rate applied by two of the appellant's subsidiaries of 3.5%, rather than the 1% offered by the appellant, to be arm's length and used it to compute the royalty that accrued to the appellant from the use of its trademarks by all its subsidiaries.

Lastly, she increased the penalty to 100% on the ground that the failure to render an income tax return was a grave contravention of s 46 (1) (a) of the Act. The gravity was accentuated by various e-mails that, she reasoned, tended to showed the appellant's propensity to avoid payment of the correct tax due by hiding information from the case manager, altering records and failing to heed the advice rendered by its transfer pricing consultant on the dangers of charging management fees at cost.

Aggrieved by the dismissal of the objection, the appellant filed its notice of appeal on 22 May 2014, and grounds of appeal and case on 18 August 2014. The respondent filed the Commissioner's case on 11 November 2014.

By consent of the parties, I granted the substitution of the appellant for the flagship and consequent condonation and extension of time within which to note the appeal on 25 November 2014.

The appellant contended that the Commissioner erred and misdirected herself at law and on the facts in ignoring the OECD TPGs in invoking the provisions of s 98 of the Income Tax Act, imputing and computing royalties and management fees to the appellant for the intragroup use of 5 of the appellant's trademarks and management services rendered by members of the group's senior management, respectively and imposing a penalty in any amount. The respondent made the contrary contentions that the Commissioner judiciously exercised her discretion in invoking the provisions of s 98 of the Income Tax Act, imputing and computing royalties and management fees to the appellant and imposing the reduced penalty of 75%. She further disputed that she was required to apply the OECD TPGs in assessing the appellant to income tax under s 98.

The issues

The following 10 issues were referred on appeal at the pre-trial hearing of 30 July 2015.

1. Whether or not there was a transaction, operation or scheme and whether such transaction, operation or scheme had the effect of avoiding or reducing tax and was abnormal in the sense prescribed under s 98 of the Act.
2. Whether or not royalties and management fees are from a source within Zimbabwe.
3. Whether or not the Commissioner exercised his powers under s 98 in accordance with the Constitution and the rule of law.
4. Whether or not the assessments raised by the Commissioner were wrong in law and in fact.
5. Whether or not applying no mark-up on management fees by the appellant and or its flagship is under these circumstances arm's length.
6. Whether or not the group employees who carry out the head office functions are employees of the appellant's subsidiary.
7. Whether or not it is abnormal to house the head office function in the flagship where the appellant does not operate as a head office.
8. Whether or not the transactions, operations or schemes were entered into with the sole purpose or with one of their main purposes being to avoid or reduce the amount of its taxability
9. Whether or not the Commissioner was correct to levy a penalty in terms of s 46 of the Income Tax Act
10. Whether or not the penalty of 100% was warranted.

At the appeal hearing, counsel for the parties reduced the issues to the four that I set out at the commencement of this judgment.

The appeal hearing proceeded by way of oral evidence and the production of documentary evidence. The duty to begin and the incidence of onus to establish on a balance of probabilities all the issues lies on the appellant. This is because it is the one that made positive assertions that the decision of the Commissioner to the objection was either a misdirection of the facts or law. It is trite that he who makes positive assertions bears the onus. See *Astra Industries Ltd* v *Chamburuka* SC 258/11; *Zupco* v *Parkhouse Services (Pvt) Ltd* SC 13/17.

<u>The oral evidence</u>

The appellant called the evidence of its former GCEO St. LD (the Saint), Group Financial Director and Public Officer (GFD or JM), Group Research Manager, (GRM or the scientist) and a purported expert in the OECD TPGs and the United Nations Practical Manual on Transfer Pricing for Developing Countries, UN Manual (Mrs RN or the expert), who between them produced 11 documentary exhibits. The respondent relied on the testimony of its field team leader, Chief Investigations Officer, OM, and its 305 paged bundle of documents filed on 27 July 2015.

The common cause facts

The appellant company was formed in 1940 and floated as a public company in July 1996. The annual report for the year ended 29 February 2004, portrayed the appellant as a dominant multinational enterprise in the business of developing and marketing certified crop seeds through its own operations in Zimbabwe and other SADC countries and Kenya. It undertook an internal reorganization programme, referred to by the Saint and JM in oral evidence, as a reconstruction scheme. The purpose, captured in the Chairman's circular to shareholders and notice convening an extraordinary general meeting (EGM) of 27 January 2005, was to best serve the interests of the appellant by placing its Zimbabwean operations, exclusive of its investments in local companies and Africa, under an as yet to be formed single wholly owned subsidiary company to be called the flagship, leaving the appellant as a non-operational holding company and allowing the Board more latitude to superintend over the all group operations more efficiently.

At the EGM of 28 February 2005, the shareholders unanimously approved the disposal of the appellant's fixed assets for ZW$ 35 643 437 113, and current assets and liabilities as at 28 February 2005 at the net valuation of the directors to the flagship subsidiary for 19 900

ordinary one dollar shares in the flagship at a premium to be set by the directors, with any credit balance appropriated to the appellant's loan account.

The investigations by the case manager revealed the following conduct of the appellant subsequent to the resolution of 28 February 2005. In the financial statements for the financial year ended 28 February 2006 to 28 February 2013, the appellant was treated as an investment company, whose sole income consisted of dividends receivable.

On 1 April 2005, the appellant, represented by JM, in the purported capacity of a director and secretary, assigned 5 trademarks to the flagship subsidiary for the princely sum of ZW$1.00, which in turn for a similar amount under the hand of JM simultaneously transferred them to SCI, the Botswana subsidiary, formed in 2000 to spearhead the appellant's foray into Africa. The appellant summarised the 2005 resolution in note 8.2.1 to its 2006 financial statements and produced consolidated group accounts of itself and all its subsidiaries, which did not relate to any identifiable juristic corporate entity. It further specially profiled and projected itself in the 2007 and 2008 annual reports as the proprietor and marketer of most of the seed varieties, and the research stations where they were researched, developed and bred. It also identified itself by its highly popularized acronym SDC.

In addition, the appellant engaged senior management members in various posts between 1 September 2006 and 8 July 2012 under the hand of either the GCEO or GFD for and on behalf of the appellant. These were the scientist on 1 September 2006, the GFD on 19 December 2006, the GCEO on 4 January 2010, the group accounting manager on 15 March 2010, the group technical services executive on 23 August 2010, the group marketing manager on 22 October 2010, the group public relations manager on 6 July 2011, who reported to the MD of the flagship and GCEO of the appellant, the personal assistant to GCEO and GFD on 18 February 2011, the group business development executive on 15 December 2011, and group treasurer, SR, on 8 July 2012. Other than the PA and group public relations manager, GPRM, all the other appointees were eligible to participate in the Group share option scheme. Some of the letters bore the list of the directors of the flagship while others carried the names of the directors of the appellant.

The job descriptions and key result areas of all these group employees covered all the subsidiaries and were the basis upon which management fees were paid to their putative employer, the flagship. The mandatory statutory PAYE remittances and cost by code reports disclosed that all the senior managers' salaries were met by the flagship and not the appellant. The PAYE remittances for the months of November and December 2009 and January 2012

and cost by code reports for 21 senior managers of July 2006, October 2007, December 2008 and February 2009, identified the taxpayer as the appellant but reflected the business partner and PAYE numbers and date stamp of the flagship.

It was common cause that these senior managers rendered management services to all the subsidiaries for which management fees were paid to the flagship at cost. The services related to specialised services in strategic, technical, production, agronomy, research, finance, internal audit and marketing and included approval of foreign currency purchases, salary increments of middle managers, approval of purchases and disposals of assets, discipline of all employees, preparation and implementation of the group human resources policy and loan guarantees and allocation of funds to all the subsidiaries. The fees were based on turnover of each subsidiary and not on a charge out rate for the service rendered.

It was also common cause that the foreign subsidiaries paid research and marketing development fees to SCI. It was further common cause that the 5 trademarks, which are the subject of this appeal on royalties, were registered in the name of the appellant with the Zimbabwe Trademarks Office on 2 October 2000, and ARIPO on 12 January 2004, and continued to be so registered during the period under investigation[2]. One of these is a general trademark with the trade name and distinctive icon of the appellant while the others have unique marks with an animal device and a product variety number indicating early, medium and long maturity levels and colour of the seed product.

On 1 April 2008, SCI executed two separate Research and Marketing Development Agreements with the Malawi and Zambian subsidiaries, respectively.

The investigations also revealed that JM had dispatched a treasure trove of e-mails, during the investigations on 15 and 17 July 2013, 27 January and 31 March 2014 to the managing directors and finance managers of the various subsidiaries inciting them to bury and withhold information from the respondent[3]. By e-mail of 26 June 2013, he instigated the *ex post facto* replacement of the first two pages of the SCI-Malawi agreement, purportedly to provide the Botswana taxman with the correct documents that were in tandem with the Malawi Exchange Control requirements. By e-mail of 5 August 2013 JM procured an employee of the tax consultant from providing unsolicited information to the case manager. On 10 January 2014, he requested the flagship's finance director Mrs N to issue the 2005 share certificates

[2] The trademarks were registered in Botswana, Malawi, Zambia, Kenya, Zimbabwe, South Africa, Lesotho, Swaziland, Namibia, Uganda, Egypt and Mozambique.
[3] P47, 57-58 of the appellant's bundle and p92-93 of the respondent's bundle.

due to the appellant. On 24 and 27 January 2014 and 17 February 2014, JM disclosed an entrenched pattern of using the Zambian subsidiary to redirect royalty income due to the flagship from the Tanzanian subsidiary. He directed the Tanzanian country manager E to redirect the payment due to the flagship from the Tanzanian subsidiary to the Zambian subsidiary and the latter to overcharge Tanzania by US$26 500 per tonne for the 20 metric tonnes of parent seed sold to the latter. The sworn purpose being to "bury reversal of research costs credited" to Zambia in either overheads or costs of sales and "minimize the taxes that arise from paying direct royalties to Zimbabwe". The flagship finance executive was instructed, on 14 February 2014, to include recoveries in other income and not under apportionments and debit research costs due to the flagship to confound the Zimbabwe case manager. It would also minimize the withholding tax due to the Tanzanian revenue authority and create fictitious withholding tax for the Zambian revenue authority from the sale originating from Zimbabwe. Some of the e-mails showed that germplasm was being dispatched to the other subsidiaries from Zimbabwe for testing, trials, development of ecologically adaptable seed, and registration of plant breeder rights, PBRs, and marketing of the developed hybrid seed.

At no time during the investigations did the appellant ever dispute that the technical and research fees payable under the Research and Marketing Development Agreements were royalties. In fact, in the tax consultant's letter of 6 November 2012, the appellant equated technical fees to royalties. It proceeded to confirm this position in the letter of 25 June 2013. JM conceded that the general trademark in issue appeared on every maize seed variety sold by all the subsidiaries while two of the distinct trademarks were sold in Kenya, Malawi, Tanzania, Zambia and Zimbabwe. According to the tax consultant's letter to the respondent of 18 January 2012, the early maturity distinct trademarked product was approved for sale in Zambia**.** In the objection letter the appellant conceded that the two medium maturity trademarked products were predominantly sold "by the Group" in Zimbabwe and Malawi.

The without prejudice letters of case of 28 May, 1 and 11 June and 19 August 2013 and 27 February and 10 March 2014 did not exclude liability but merely the taxable percentage. The efficacy of the "without prejudice" principle appears to me to be tenuous in tax related matters in view of the strong sentiments propounded by MALABA JA, as he then was, in the *Commissioner of Taxes* v *Astra Holdings (Pvt) Ltd* 2003 (1) ZLR 417 (S) at 428B that the duty of the Commissioner is to tax and not untax an eligible taxpayer. Again, in the minutes between the parties of 22 July 2012, the appellant conceded that the fees were royalties.

The respondent imputed management fees to the appellant on the basis that:

1. The ZSE listing rules require employees to have certain experience;
2. The GCEO and GFD were executive directors of the appellant;
3. The annual financial statements indicated that the appellant was operational;
4. The appellant employed group employees, who had extant contracts with it;
5. It had a physical head office from which it rendered administrative, technical, financial and commercial management services through the group employees to its subsidiaries, which negated the assertion that it was an investment holding company holding shares with no employees and other business activities.

In the absence of any comparables from the appellant, the respondent imputed management fees to the appellant of US$832,155.00 for 2009, US$1,882,819.55 for 2010; US$ 2,967,647.50 for 2011 and US$2,680,158.75 for 2012 tax year. These amounts constituted a transfer price of cost plus 25%, translated as a gross profit percentage of 20%. The "cost" was derived from the general head office expenses disclosed in the audited financial statements of the flagship. These were marked-up by 25% and then allowed as a deduction, thus effectively taxing only the mark-up on the deemed expense.

She also attributed royalties for the use of the 5 trademarks to the appellant of US$1,998,824.55; US$ 2,215,841.00; US$ 2,700,651.05 and US$2,505,374.04, for each respective tax year.

The testimony of JM

JM joined the appellant before the reorganisation after which he was appointed the financial director of the flagship on 19 December 2006 and the GFD, company secretary and public officer of the appellant from 1 January 2007. He served as the Group Treasurer until 1 September 2012. He was also a member of each subsidiary's board of directors.

The pith of his testimony was that the appellant transferred its head office functions and all operations lock, stock and barrel to the flagship on 1 April 2005, from which date it became an investment holding company. It ceased to have employees, other than the GCEO and GFD, on that date. It further cast the responsibility of managing the subsidiaries on the flagship, which employed group employees who provided management services at cost from which management fees were payable.

On 1 April 2005, the appellant transferred 5 trademarks to the flagship which in turn simultaneously transferred them to the Botswana subsidiary. The effect of the transfer was that the seed varieties pertaining to these trademarks constituted the genetic material that was used

to breed ecologically adaptable in country seed varieties from which each subsidiary derived and owned in country PBRs.

He produced exhibits 4A and 4B, the audited consolidated income statements for the financial year ended 31 March 2010, to prove that the appellant only earned dividend income from the subsidiaries and not any other income from the sale of maize, management fees or royalties. He ascribed the technical fees paid by the in country subsidiaries to SCI, to the funding for research and marketing activities conducted by SCI in the breeding, testing, trials and registration of PBRs during the incubation years of each subsidiary, which were underscored in the Research and Marketing Development Agreements executed with these subsidiaries. The incubation costs for which royalties were paid were highlighted in exh 6A and 6B. To his knowledge and experience, trademarks *per se* were valueless to the owner. Their value was derived from rigorous research and development, trial, testing, field demonstration and marketing in the host countries for a minimum of 3 to 4 years before registration, not as maize seed varieties but as plant breeder rights by either the owners or users or both. In those instances, like the present, where the owner did not undertake such activities and the seed varieties attached to the trademarks were not sold in country by the subsidiaries, no royalty was due to the owner. Rather, the subsidiaries owned the PBRs specific to their host markets and were not legally obliged to pay royalties to the appellant.

He also attributed the impression that group employees belonged to the appellant to the inadvertent and erroneous use of old templates and stationery and the failure to distinguish the juridical difference between the appellant and flagship by the PA shared between the GCEO and GFD.

He maintained his evidence in chief under cross examination. He conceded that the failure to charge mark-up for management services was abnormal, that OECD TPGs were at the time inapplicable in Zimbabwe, that the custodial costs sought to be excluded in exhibit 5 were actually paid to the flagship by the other subsidiaries and the question of bad debts was not contemporaneous but prospective and in any event in the discretion of the Commissioner. The computation of 25% was mathematically correct. All seed varieties sold in country bore the generic trademark of the appellant thus making the product inseparable with the trademark.

Assessment of the witness

He has extensive and intimate knowledge of the operations of the appellant and all its subsidiaries. He found it very difficult to identify the senior managers of the appellant who made it compliant with r 4.6A of the listing requirements of the ZSE. He prevaricated between the GCEO and himself, on the one hand and eight others on the other. His prevarication was motivated by the realization that admitting that appellant had senior management would automatically make it liable for management fees while denial made it in breach of the listing rules. He was on the horns of a dilemma, between the proverbial hard place and a rock. He failed to explain why he and the GCEO, whom he admitted without equivocation to be employees of the appellant were signing engagement letters for Group personnel after the reorganisation of 2005, as agents of the appellant. The *caveat subscriptor* principle obviously applied to them. He miserably failed to wriggle his way out of the space between the proverbial hard place and rock that he found himself in. He went to the absurd extent of accusing the case manager of forcing appellant to stamp its logo on the extracts where this logo appears. He could neither proffer a reasonable explanation why the group treasurer used the same logo on his internet signature in domestic and external communication, nor why the public relations manager was being engaged to service both the appellant and the flagship. He was unable to explain how such errors could persist to 12 July 2012 when the last of the group employees, the group treasurer, was engaged by the appellant.

It was disingenuous of him to seek to apply the OECD-TPGs to management fees in retrospect rather than contemporaneously to the detriment of our own tax legislation. He failed to make full and frank disclosure to the Commissioner and sought to burden the Commissioner with the onus of eliciting the appropriate questions from him contrary to his clear obligation set out in *ITC* 15/94 (57 SATC 259) thus:

> '…an obligation rests upon a taxpayer to render an accurate and full return on which he can be assessed and not to do so in a vague or ambiguous manner casting the onus upon the revenue authorities to elicit the complete picture by a series of queries."

His assertion that trademarks carried no embodied value was demonstrably false. In the assignments they were not transferred for free, but for a dollar[4], they were registered at both the Zimbabwe Trademark Office and ARIPO for US$27 965[5], a SCI accounting entry valued

[4] In the 2005 assignments.
[5] Expended at local trademarks office and ARIPO between 23 February and 18 March 2013 in invoices Annexure E of appellant's case.

them at US$31 000[6], while an e-mail by JM to Tanzania of 14 February 2014 estimated their value to be US$530 000. That these trademarks were already known in the subsidiaries host markets exports was unambiguously demonstrated by the 29 February 2004 annual report of the appellant which boasted that exports already abounded before the 2005 reorganisation.

He gave the false impression that his laptop was unlawfully seized when it was taken by consent of his GCEO and tax consultant. The seizure coloured his relationship as a public officer, with the case manager to the detriment of the appellant. I found him to be an insincere and generally untruthful witness who failed to act with integrity in the statutory position of a public officer.

The Saint.

The Saint was the GCEO of the appellant between 2002 and 2009. The internal reconstruction took place under his watch. He testified that the reorganisation was designed to promote operational efficiency in the group and not the accrual of tax benefits to the appellant. The avoidance, postponement or reduction of the appellant's tax liability was never discussed by the board at the time. He had no recollection of whether the respondent was ever apprised of the process. He, however, studiously declined to comment on the suggestion that the reconstruction was just a tax avoidance scheme. He maintained that the appellant never recruited any employees after the reconstruction. He confirmed that the flagship did not gross up the management costs incurred on behalf of the subsidiaries. He indicated that no royalties were charged for the use of the appellant's trademarks within the group as they were unknown in the new markets. He maintained his evidence in chief during cross examination. He failed to satisfactorily explain why the letters of employment of the group personnel signed by him, his successor and JM after the reconstruction indicated that they were being employed by the appellant. To the extent that he maintained this aspect of his evidence, he was an untruthful witness whose testimony was affected by the same malady that afflicted JM's evidence. He, however, conceded that the failure to charge mark-up on management costs was not arm's length.

The Scientist.

The scientist was promoted to his position on 1 September 2006. He was in charge of all the research and breeding projects carried out at various research stations and sites within the entire group. He prepared, controlled and monitored the annual budget for research and

[6] Para 133 of appellant's case.

development within the group. He was responsible for the acquisition and improvement of germplasm by conventional and biotechnical methods. Germplasm constitutes the foundational material for breeding, developing, testing and registering plant breeders' rights in the flagship and subsidiaries outside Zimbabwe. He worked in close liaison with the group marketing manager to promote the varieties emanating from his division. He testified that the know-how used in breeding genetic plant material used in producing seed varieties was carried out in Zimbabwe for and on behalf of all the subsidiary companies. He, however, was unable to quantify the value of such know-how. While he was able to quantify, in exh 8, the cost of breeding, testing, releasing and registering new maize varieties at local research stations, he was unable to quantify the value of the distinctive know-how inputted in the breeding process. His testimony in this regard was confirmed in his e-mail to JM of 11 June 2013. His technical evidence on Value for Cultivation and Use, VCU, and Distinctiveness, Uniformity and Stability tests, DUS, underscored his intimate involvement in the research and development projects undertaken outside Zimbabwe by the appellant's subsidiaries. He maintained under cross examination that he was employed by the flagship and not the appellant. He did not know how the distinctive input of local research stations in breeding seed varieties was compensated for by the other subsidiaries. I formed the distinct impression that his evidence in chief was choreographed to underplay his pivotal role in the research activities of the whole group, a position he seems to have abandoned under cross-examination.

The Expert

The last witness was not a factual witness but a purported expert in the OECD TPGs. Her claim to expertise was premised on the four years she spent at the South African Revenue Service (SARS), between 2001 and 2005, as the founding head of the cross-border inter-company transaction desk, where she assessed the propriety of management fees and royalties of the kind imputed to the appellant by the respondent in the present matter. She also relied on the 15 years she worked in the private sector for international accounting firms as a transfer pricing advisor to multinational enterprises.

She conducted a desktop review of 12 Royaltystat data bases on transfer pricing agreements between independent parties in the agricultural industry to ascertain whether royalties were charged for the use of trademarks. Six of the agreements were in the fresh produce category and the other six were in the hybrid seed group. She discounted one agreement in the hybrid seed industry, in which royalties were charged, because it was between

related parties. She found that only two of the remaining five hybrid seed agreements covered trademarks. These two were concluded between the same parties[7] and embodied non-exclusive royalty free licences. The remaining three hybrid seed agreements and all the six fresh produce agreements charged royalties together with other intangibles like patents, technology, know how, trade secrets or software of between 4% and 6% of the net sales. She concluded, on the basis of these findings, that royalties were not charged separately for trademarks in the hybrid seed industry because they had no value independent of other underlying intangibles, that royalties for the sale of trademarked goods were either much reduced or eliminated altogether by the in country production, registration and marketing efforts of the local subsidiary and that housing head office functions in a subsidiary was in consonance with OECD TPGs concept of "group service centre" and "shared services centre".

The respondent calculated the average net profit margin of the appellant by dividing the net profit by sales based on the entire group turnover (being the sales to unrelated parties only) at 20% and reworked the figure to a cost plus 25% mark-up. It was common cause that the figures were mathematically correct[8]. The expert testified that this methodology was fundamentally flawed as it suggested that management services where solely responsible for the entire sales. She stated that there was no correlation between the profit before tax and maize sales as the profit before tax was a function of all seed sales and interest income. She further stated that the formula did not eliminate shareholder costs and that the mark-up was too high. Her computations, which were based on the tables in exhibit 5, constitute exhibit 11. It is not necessary to reproduce her computation tables. The computations showed that the amounts chargeable in each year were much less than the taxable income figures imputed by the respondent. And even then, the actual management fees charged by the flagship to the subsidiaries were much higher than they should have been had the cost of shareholder activities been discounted. The respondent imputed royalties' payable, imposed a charge of 3.5% on the gross sales of the seed varieties sold by the Group, without limiting it to the sales generated by these brands, and assessed the appellant to income tax on the imputed amounts.

In assessing her evidence, I am guided by an insightful article that appeared in *De Rebus* of May 2015[9] entitled "*Beware of the Hired Gun-Are expert witnesses unbiased*". The learned

[7] The two parties were Syngenta on the one hand and Delta & Pine Land Company on the other.
[8] The formula was Gross Sales -Intra-Group Sales -Cost of Sales ÷ Cost of Sales ($\frac{GS-(IGS+CS)}{CS}$).
[9] 36 [2015] DE RUBUS 76.

author captures the apt warning regarding the testimony of expert witness given in *Lord Arbinger* v *Ashton* (1873) 17 LR Eq 358 at 378 that:

> "Undoubtedly there is a natural bias to do something serviceable for those who employ you and adequately remunerate you. It is very natural, and it is so effectual that we constantly see persons, instead of considering themselves as witnesses, rather consider themselves as paid agents of the persons who employ them…. What it all means is this, of an expert is required originality, objectivity and unbiased assistance to the court. The expert opinion should be based on all the facts or assumptions. No expert should be unwilling to make concessions about something either falling within his or her expertise or not known when first expressing that opinion."

The efficacy of her testimony was undermined by seven factors. Firstly, her review and results were not original but a mere regurgitation of an earlier one, apparently conducted by the appellant's lead representative in this appeal, Mr *Erasmus* and presaged in para B1.3.8.1 of the objection. Secondly, the review of the two non-exclusive royalty free licence agreements failed to read the royalty free clause, clause 3.8, in conjunction with clause 6.2, which specifically mandated Delta to pay a royalty to Syngenta for the right to produce, multiply and sell the seed to which the royalty free trademark licence related. In my view, these two agreements did not fall into the ambit of pure royalty free agreements but of the other nine. Even if they did, a mere two agreements in the whole wide world would not constitute the critical mass to justify the proposition that royalties are not chargeable for the use of trademarks in the hybrid seed industry. The number is just too insignificant to conclusively extrapolate such an earth shattering principle. After all, the link between the non-exclusive royalty free licence to the royalty payable for the production, sale and propagation of the seed to which the royalty relates belies the further proposition that trademarks standing on their own in the hybrid seed industry are valueless. The practical hard fact is that a trademark, which the parties correctly equated to a brand, cannot stand on its own. It is always attached to, and bears testimony to the quality of, some product, manufacturing process or advertising format. See *DEB (Pvt) Ltd* v *Zimra* HH 664/19 at p 7 and "*IP Handbook of Best Practices"*[10] by Tucker and Ross who opines that capital outlay in the creation of a trademark encodes consistent quality and continuous availability and that value is enhanced by marketing and acceptance.

Thirdly, and more importantly, she failed to establish that these guidelines constituted customary international law and to her credit conceded under cross examination that they were not law. They were therefore inapplicable in Zimbabwe which had not domesticated them as

[10] Chapter 11.6 p1063 at p1 511 of appellant's bundle.

had done South Africa in 1995. Fourthly, she swallowed hook, line and sinker the assertion by the appellant that it was not liable for both these fees while cursorily dismissing the bases for the Commissioner's contrary assertions.

Fifthly, she failed to demonstrate by reference to any data base empirical evidence on the propriety of housing head office functions in a subsidiary company and to articulate the juristic nature of a group company. She appeared to treat all the subsidiaries of the appellant as the "Group Company" and the appellant as a "Company"; thereby giving the incorrect impression that the appellant, which was the holding entity, was a subsidiary of the ambiguous Group. This is contrary to the provisions of s 143 (5) and s 144 (1) and s 145 (2) of the Companies Act [*Chapter 24:03*][11] which categorically equate the Group with the Holding Company. Sixthly, she portrayed the false impression that the arm's length principle, which measures the conduct between related parties against that of independent parties in comparable transactions undertaken in comparable circumstances, was a progeny of paragraph 1.110 of the OECD TPGs, when in fact it is a common sense based universal standard which predated the promulgation of OECD TPGs. Seventhly, her computations of management fees, recorded in exh 11 and based on the figures in exh 5, *inter alia,* showed that the flagship did not apply the much touted OEECD TPGs in levying management fees against the in country subsidiaries. There was therefore no basis for applying these guidelines to the appellant in this appeal. Doing so would make this Court complicit in aiding the appellant circumvent the very mischief s 98 is designed to guard against. She could not dispute the further fact that management services provided by the group employees were not limited to maize sales only but to all income raising activities of the benefitting subsidiaries.

Lastly, Royaltystat agreements had detailed contractual arrangements on ownership rights over improvements derived from collaborative efforts with or solely by the licensee, the terms of which were hidden from the respondent and this Court in the undisclosed agreements between the appellant and its subsidiaries. In the "Group Proposal to Review Transfer Pricing Framework" of 24 October 2013, the international transfer pricing consultant was availed the Intergroup Transaction Framework, 3 flagship Management Fee Agreements, 2 Q Management Fee Agreements, 9 SCI Royalty Agreements, 13 Intercompany trading agreements, 7 Technical Fees Agreements of the flagship and 6 SCI Management Fee Agreements, which JM no doubt

[11] Where group accounts are a combination of the accounts of both the holding company and its subsidiaries.

"buried" from the prying eyes of both the respondent and this Court. In my assessment, she was a hired gun.

It was common cause that the Commissioner has an untrammelled discretion to compute royalties chargeable once all the jurisdictional facts in s 98 are met. Her discretion in this case was reinforced by the concession given by the appellant to utilize the template of the SCI-Malawi agreement. The totality of the evidence adduced by the appellant and especially from the scientist showed that the research referenced in that agreement denoted the manipulation of germplasm and propagation of initial hybrid seed from Zimbabwe, which had suitable research stations and not Botswana, which had no research station.[12]

In the present case, the underlying trademarks were fully developed. They consisted of the general trademark with the logo of the owner and distinct trademarks for specified hybrid seed varieties. The general logo was used by all the subsidiaries on all the seeds that they sold. Three of the four distinct trademarks were used on the hybrid seeds to which they related, which were sold in Kenya, Malawi, Tanzania, Zambia and Zimbabwe. The 2010 variety register shows that the early maturity variety trade mark was purportedly registered under SCI in 2001 while the two medium maturity varieties were purportedly registered in 1999.

The suggestion that these trademarks were either unknown in these countries or were popularised by the marketing efforts of the local subsidiaries was contrary to the available documentary evidence. The appellant's annual report for the financial year ended 29 February 2004, showed that the appellant was already selling the trademarked seed varieties in these countries. This was further confirmed by the letter from the appellant's tax consultant to the case manager which categorically stated that the appellant sold trademarked seeds in these countries[13]. And again reinforced by the attempted simultaneous assignments of the trademarks made by the appellant to the flagship and the flagship to SCI purportedly on 1 April 2005. This was consistent with the appellant's desire to create SCI, already in business since 2000, as its major special purpose vehicle for consolidating existing and opening new markets through the use of existing trademarks and the development of new ones, in Africa, outside Zimbabwe. So at the time of the 2005 reorganisation, these trademarks and the products to which they related were known and sold in these markets. The development, enhancement, maintenance, protection and exploitation functions of the trademarks had long been effected by the appellant before the reorganisation exercise. There was no basis for the products which were already on

[12] Zimbabwe contributed average research of 77% against Botswana's 3% during these tax years.
[13] 12 January 2012.

sale to undergo new trials and testing as suggested by all the witnesses called by the appellant. The evidence of the appellant's witnesses related to new trademarks and their related plant breeders' rights or plant intangibles and not the trademarks we are concerned with in this appeal, other than the general trademark, which attaches to all varieties, new and old as the signature mark of the appellant.

The Chief Investigations Officer.

He was the point man of the respondent in the interactions with the appellant. He made the key decisions which led to the invocation of s 98 and the imputation of the taxable income from management fees and royalties to the appellant. He confirmed that in minuted discussions, correspondence and official documents between the parties, the appellant referred to the research fees in the SCI-Malawi agreement which covered research, development, trials, testing, registration of plant breeder rights and marketing of the resultant hybrid seed varieties during the first 3 to 4 years performed in conjunction with the subsidiaries as royalties. In other correspondence, the appellant disputed the accrual of royalties to SCI from the five trademarks in question maintaining that royalties were not chargeable for the use of trademarks in the seed hybrid industry. The essence of his testimony was that the Commissioner repositioned and corrected the flow of management fees and royalty income to the appellant, to whom such income accrued before it was diverted to the flagship and SCI, respectively. The computations based on the average profit before tax as opposed to 2% of group turnover resulted in additional accrual of US$ 665 724 instead of US$ 1 539 807.06.

The Chief Investigation Officer's testimony was factual. It was supported by the documentary evidence at hand. It was not discredited during cross examination. I accept it as the truth of what transpired during his interactions with the appellant.

The application of OECD TPGs in Zimbabwe.

It was common cause that OECD TPGs were not legislated in Zimbabwe at the time the assessments were raised. The appellant established that at the time of the assessments the guidelines had been adopted by 34 members of the OECD, legislated by only 11 African countries and possibly applied by a total of 85 countries in the whole wide world, including Kenya through the case of *Unilever Kenya Ltd* v *Commissioner of Income Tax* [2006] 2 EA 334 (HCK), which incidentally, the local case of *S* v *A Juvenile* 1989 (2) ZLR 61 (S) at 72, regarded as a pacesetter in the use and grafting of international soft law to local law, which could only enrich local law rather than side line it. *Per contra*, the respondent established that

Malawi rejected the use of the guidelines to overshadow local law in *The State* v *Commissioner General of Malawi Revenue Authority, Ex parte Eastern Produce Malawi Ltd* Judicial Review Number 43/2016 at pp 11-12[14].

On the basis of the above facts, the appellant submitted that the OECD TPGs were applicable in Zimbabwe because they had achieved the status of customary international law. The Commissioner made the contrary submission that they were inapplicable in Zimbabwe as they had not achieved any such status. She argued that they could at best be regarded as customary international norms.

Section 46 (1) (c) of the Zimbabwean Constitution[15] enjoins the use of international law in conjunction with other factors in interpreting the Declaration of Rights in Chapter 4 thereof and all treaties and conventions to which Zimbabwe is a party. Section 326 declares customary international law, as long as it is consistent with the Constitution and local legislation, to be part of the *corpus juris* of Zimbabwe and enjoins "every court and tribunal" to "adopt any reasonable interpretation of the legislation that is consistent with customary international law applicable in Zimbabwe, in preference to an alternative interpretation inconsistent with that law." Lastly, s 327 excludes the incorporation of international conventions, treaties and agreements that have not been domesticated into Zimbabwean law.

The OECD TPGs are a derivative of the OECD Convention. Their application to the interpretation of s 98 of the Income Tax Act is, therefore, specifically excluded by both s 46 (1) (c) and 327 of the Constitution. They can, however, be applied if they meet the requirements of s 326 of the Constitution.

The question of whether they constitute customary international law appears to have been authoritatively answered by Jens Wittendorff in his book entitled "*Transfer Pricing and the Arm's Length Principle in International Law"*[16]. He makes the following pertinent observation at p 287:

> *"*The customary international law has an objective element in the form of a uniform and consistent practice among States or at least a majority of them. The objective test is the cornerstone of customary international law. There is also the subjective element according to which States must act out of a sense of obligation to do so."

[14]"I am of the humble view that where local legislation provides for the law, it is always imperative to apply that law and use any international instruments in interpreting that local law. I do not think that using the international instruments while side lining local legislation is allowed. Doing that, in my considered view, will defeat the intention of the framers of the local legislation."

[15] The Constitution of Zimbabwe Amendment (No. 20) of 2013.

[16] 2010 Kluwer Law International.

And at p 290, he aptly states that:

> "At the international level, the OECD has never referred to the arm's length principle as expressing customary international law. On the basis of the above, the arm's length principle cannot be assumed to qualify as customary international law. This means that Article 9 does not have a special status in international law since the OECD model and Commentary are not regarded as being customary international law."

Wittendorff's conclusion is in consonance with the evidence of the purported expert witness on the point. She readily conceded under cross examination that the guidelines were not rules of law. In my view, the guidelines perpetually remain work-in-progress, being subject to unending and periodic reviews, which eschew their ability to ever achieve the status of customary international law. Being subject to change with each periodic review, they lack the consistency and certainty required of customary international law.

To the same effect was VISRAM J in the *Unilever Kenya* case, at p 12 where he said:

> "Now these guidelines do not form the laws of the countries concerned. They are simply guidelines, guiding the world of business that is business enterprises and the taxing authorities of those countries in arriving at proper transfer pricing policy principles for the purposes of computation of income tax. And especially because of the absence of any such guidelines in Kenya, we must look elsewhere. I have no doubt in my mind that the relevant guidelines such as the TP principles are not just here for relaxed reading. These have been evolved in other jurisdictions after considerable debates and taking into account appropriate factors to arrive at results that are equitable to all parties. It would be foolhardy for any court to disregard internationally accepted principles of business as long as these do not conflict with our own law. To do otherwise would be highly short-sighted." (My underlining for emphasis).

See also the *Glenister*[17] case where MOSENEKE DCJ and CAMERON J said of a kindred OECD Report:

> "The OECD Report is not in itself binding in international law but can be used to interpret and give content to the obligations in the Conventions we have described."

The appellant, thus failed to establish that the OECD TPGs are part of customary international law. It also failed to establish that its preferred application of the guidelines was consistent with s 98 of the Income Tax Act in the light of the apposite and binding interpretation rendered by the Rhodesian Appellate Division, the precursor to our Supreme Court, to s 91, also the precursor to our s 98 of the Income Tax Act in *Commissioner of Taxes* v *Ferera* 1976 (2) SA 653 (RAD). At 659A, MACDONALD JP, as he then was, said:

> "It is equally absurd to suggest that the Legislature could possibly have intended, as has sometimes been suggested, that taxpayers would not be subjected to those powers if the means or the manner employed to avoid, postpone or reduce tax was a means or manner normally employed for this purpose."

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[17] *Glenister v President of the Republic of South Africa & Ors* Case No. CCT 48/10 [2011] ZACC 6 para [187] in reference to *Specialised Anti-corruption Institutions: Review of Models (OECD Report)* and not OECD TPGs

And held at p 659F:

> "When by a transaction, operation or scheme income has been prevented from accruing in a way it would "normally and naturally accrue", it is no answer for the taxpayer to say that quite a normal method of tax avoidance was used to bring about this result. The acceptance of such an answer would defeat the purpose of the section."

It is my finding that that the use of the guidelines by possibly 85 countries, which regard them as normal, did not justify their adoption by the appellant in the face of a contrary interpretation rendered by our Supreme Court. In any event, the majority of these countries utilized them by dint of their respective treaty obligations and domestic legislation. I am satisfied that the appellant failed to establish that the guidelines had the force of law in Zimbabwe. The Commissioner correctly disregarded them in raising the assessments and in his determination of the objection.

<u>The relevant legislative provisions</u>

The power of the respondent to levy and collect tax is provided in s 6 of the Income Tax Act [*Chapter 23:06*], which states:

> **"6 Levy of income tax**
> There shall be charged, levied and collected throughout Zimbabwe for the benefit of the Consolidated Revenue Fund an income tax in respect of the taxable income, as defined in this Part, received by or accrued to or in favour of any person during the year of assessment ending the 31st March, 1968, and each succeeding year of assessment thereafter."

Royalties are charged in terms of s 8 (1) (d) (iii) of the same Act, which provides that:

> "**8 Interpretation of terms relating to income tax**
> (1) For the purposes of this Part—
> "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—
> (*d*) any amount so received or accrued from another person as a premium or like consideration paid by such other person—
> (i) ……
> (ii) ……
> (iii) for the right of use of any patent, design, trade mark, copyright, model, plan, secret process or formula or any other property which, in the opinion of the Commissioner is of a similar nature;"

Section 2 (1) of the Income Tax Act incorporates by reference the definition of trademark in the Trade Marks Act [*Chapter 26:04*] thus:

> "trade mark" means a trade mark as defined in subsection (1) of section 2 of the Trade Marks Act [*Chapter 26:04*]"

The relevant section in the Trade Marks Act states:

> "trade mark" means a mark (any graphic sign capable of distinguishing goods/services of one undertaking from those of another undertaking) which is used or proposed to be used in relation to goods or services for the purpose of—
>
> (*a*) indicating a connection in the course of trade between the goods or services and some person having the right, either as proprietor or as registered user, to use the mark, whether with or without any indication of the identity of that person; and
>
> (*b*) distinguishing the goods or services in relation to which the mark is used or proposed to be used, from the same kind of goods or services connected in the course of trade with any other person; but does not include a certification mark;"

Lastly, s 98 stipulates:

> "**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."

<u>Application of the law to the facts</u>

The source of the management fees and royalties

It was common cause that the management fees were deemed to be from a source in Zimbabwe. The appellant disputed the source of royalties could be attributed to Zimbabwe. The evidence led by the appellant showed that the scientist was not only the pivot and brains behind all hybrid seed research and development but in conjunction with the group marketing executive centrally managed, controlled and coordinated the skill, wits and labour of the in-country employees who partook in the research, development, propagation and marketing of new seed varieties to which the general trademark attached. The appellant was entitled to

royalties calculated at an agreed percentage of net sales less the contributions of the non-title holders. The source of the royalties was the country from which the initial skills, wit and labour originated. Coincidentally, the formula specified in the SCI-Malawi agreement for research fees is the one that abounds in all the Royaltystat agreements used by the appellant. The intellectual property attached to these trademarks originated in Zimbabwe in which the seed varieties attached to all the trademarks were sold and from which they were further registered or used as foundation material in developing new varieties registered as PBRs in the host countries. The source requirements prescribed in s 12 (1) (a), (b) and (c) of the Income Tax were therefore met[18].

The contention advanced by the appellant that the phrase "premium or like consideration" in s 8 (1) (d) of the Income Tax Act connotes a payment in excess of the royalty chargeable and not the royalty itself by reference to a similar phrase embodied in a lease agreement referred to by Silke para 4.56 Lexis Nexis is incorrect. Silke states that:

> " the words 'premium or like consideration' in so far as they refer to the relations between a lessor and his lessee, refer to a consideration having an ascertainable money value passing from the lessee the lessor, whether in cash or otherwise, distinct from and in addition to rent….For example, if a lessor agrees to let to a lessee land for a lump-sum payment of R1000 000 in addition to a monthly rent of R25 000, the R100 000 is a premium….since it is a consideration passing from a lessee to a lessor in addition to the rent. *CIR v Butcher Bros (Pty) Ltd* 1945 AD 301, 13 SATC 21; *Turnbull v CIR* 1953 (2) SA 573 (A), 18 SATC 336."

It is incorrect because a royalty chargeable for the use of trademarks is not analogous to rentals charged for the use of property. A royalty constitutes the premium or like consideration paid for the right to use the trademark or other intellectual property based on the value of sales. The royalty payable is in addition to any licence fees that may be charged annually. The rental in a lease agreement is analogous to the licence fees payable. The additional payment of a royalty on top of the licence fees is what constitutes the "premium or like consideration" referred to in s 8 (1) (d) of the Income Tax Act. The construction of that phrase in the manner suggested by the appellant would render nugatory the inclusion of royalties in the taxable income of a taxpayer, emasculate the application of both the general wording of s 8 (1) and the specific wording of sub-para (d) of s 8 (1) and defeat the intention of the Legislature to include royalties in a taxpayer's taxable income.

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[18] The contract of sale was executed in Zimbabwe, service/work derived from trade by a Zimbabwean company, and rendered by Zimbabwe based employees in- the host country.

I proceed to determine whether the provisions of s 98 were properly invoked in respect of the transfer of the head office function, management fees and royalties

The head office function

Whether or not there was a transaction, operation or scheme in respect of the head office function and whether such transaction, operation or scheme had the effect of avoiding or reducing tax and was abnormal in the sense prescribed under s 98 of the Act.

The provisions of s 98 have been judicially construed and applied in this country for a considerable length of time. See *Commissioner of Taxes* v *Ferera* 1976 (2) SA 653 (RAD), *G Bank Zimbabwe Ltd* v *Zimbabwe Revenue Authority* 2015 (1) ZLR 348 (H) *and H Bank Zimbabwe Ltd* v *Zimbabwe Revenue Authority* 2015 (1) ZLR 1007 (H). The section deals with circumstances where there is an avoidance, postponement or reduction in tax liability and the Commissioner forms the opinion that the avoidance, postponement or reduction was the sole or one of the main purposes of the transaction. He may then determine the tax liability by ignoring the offending transaction or reversing or limiting its impact. He is obliged to consider whether the transaction was conducted in a way (means and manner) that is not normally employed or created rights and obligations not normally created between independent parties dealing at arm's length. The GAAP does not affect legitimate exemptions, deductions and credits but is concerned with the diversion of income by hook or crook, which would have accrued to the taxpayer, to a different entity.

In the instant case, the Commissioner formed the opinion and was thus satisfied that both management fees and royalties accrued to the appellant but by sleight of hand by way of fictionally placing group employees under the flagship and the SCI-Malawi agreement, which income was diverted to the flagship and SCI, who in reality had not earned any such income. This satisfaction connotes his justification for attaching liability to the taxpayer. The Commissioner thus wields an extraordinary and far reaching power, which negates the freedom of contract enjoyed by taxpayers. The appeal attacks this satisfaction.

The respondent assessed the appellant to income tax on the basis that it created three transactions, operations or schemes between 28 February 2005 and 25 November 2013, when the appealed assessments were issued. The first TOS was allegedly created by virtue of the resolution unanimously passed by the appellant's shareholders on 28 February 2005 and implemented on 1 April 2005. The Commissioner found that this TOS involved the formalistic and not substantive transfer of the head office functions of the appellant to the flagship. The

second concerned the rendering of management services by the appellant to all its subsidiaries for which the management fees payable were charged at cost and diverted to the flagship. The third was the utilization of the appellant's general trade mark and 4 distinct trademarks by all its subsidiaries without paying any accrued royalties to the appellant, which royalties (compensation for the use of the intangible assets) were, however, diverted to the Botswana subsidiary.

I find that the conduct of the appellant in each of these three respects constituted a TOS, despite its spirited denial during the investigations, objection, on appeal and in argument. In his evidence in chief, JM described the 2005 events as a "scheme of reconstruction" and "a scheme of internal reorganisation". It was therefore a scheme that was entered into and executed by the appellant, which falls into the ambit of a TOS.

Whether it had the effect of avoiding or postponing liability for any tax or of reducing the amount of such liability.

The scheme of reconstruction undoubtedly had the effect of avoiding or reducing the tax liability of the appellant. This is apparent from the financial statements issued by the appellant for the year ending 28 February 2005 and subsequent years, in which the appellant is designated as the Company and its subsidiaries as the Group. The tax liability of the appellant in those financial statements was, as a hard matter of fact, much reduced than in the year ending and preceding 29 February 2004.

Whether the abnormality opinion (both the way and manner, and the creation of unusual rights or obligations absent between independent parties) of the Commissioner was correct.

These two jurisdictional factors are disjunctive. The existence of any one of these factors suffices. The Commissioner formed the opinion that the manner in which the reconstruction was effected of completely divesting the head office functions of appellant to the flagship was abnormal. The bases for that finding were that post the divestiture, the appellant continued to directly employ group personnel, who provided management services, which were remunerated at cost by the flagship. Further that it did so in compliance with listing rule 4.6A of the listing rules of the local bourse. The appellant contends that this finding was wrong. It admitted that the letters of employment of group personnel were signed for and on behalf of the appellant and were engaged as its employees. By reference to the divestiture and PAYE remittances and cost code reports of the relevant tax periods, the appellant attributed the "mistakes" to "typing errors" by ignorant personal assistants. It further treated the letters as

mere form and the divestiture and tax remittance documents as the substance of the scheme. Lastly, it contended that listing r 4.6A as read with listing r 15.2 (a) did not preclude the divestiture of head office functions.

I do not accept the appellant's explanations for four reasons. Firstly, the letters all emanated from and were signed by the highest officers of the appellant on its behalf, who were all aware of the true position of the appellant and cannot blame the personnel assistants for their own deliberate actions. The *caveat subscriptor* rule is an adequate antidote to their actions from which they cannot legally and factually resile. Secondly, the divestiture could not and did not stop the appellant from employing group personnel directly. That they were remunerated by the flagship on behalf of the appellant was a separate contractual arrangement between the appellant, the flagship and the group employees. This was analogous to the pithy comparison made by Mr *Matinenga* that a son who pays his father's cowhand does not become the employer. In my view, the payments and tax remittances by the flagship portrayed a picture, a mere appearance, of the group personnel as employees of the flagship when in reality and substance, they were direct employees of the appellant.

The two contentious listing rules provide that:

> "4.6A: The directors and senior management of an applicant must have collectively appropriate expertise and experience for the management of the group's business. Details of such expertise and experience must be disclosed in any listing particulars prepared by the company (see para 7B1 to 7B3)."
>
> "15. 2: In evaluating a listing of an investment entity the Committee will have regard to the following fundamental principles:
>
> (a) Those managing the investment must have adequate experience;
> (b) ….
> (c) The investment entity must be a passive investor and neither it nor its management company nor any director or manager of the investment entity or its management company should control, or seek to control, be actively involved in the management of the companies, or other entities in which it invests."

The preamble to r 4.6 provides that the rule deals with the general conditions for listing that apply to all markets while r 15 deals with additional and alternative requirements specific to investment entities. The preamble to r 15 defines an investment entity as "including investment companies, investment trusts and unit trusts whose principal activity is the investment which for the purpose of this section includes private companies. The entities, by their nature, do not seek to control or be involved in the day to day management of their investees and are therefore passive investors."

Other relevant definitions in the listing rules are:

> "Applicant: an issuer which is proposing to apply, or is applying, for admission of any of its securities"
>
> "Group: a holding company, not itself being a wholly owned subsidiary, together with all the companies being its subsidiaries"
>
> "Holding company: a company that has one or more subsidiaries"
>
> "Investment entities: investment companies, investment trusts and unit trusts whose principal activity is the investment in securities."

What arises from these definitions is that the appellant was the applicant immediately prior to its listing in 1998 and not on 1 April 2005 when it purportedly transformed into an investment entity. It never listed as an investment entity in 1998, so the provisions of r 15 (2 (a) did not and do not apply to it. The rule that applied and applies to it is r 4.6A. That rule governed its listing conditions in perpetuity. The appellant was the applicant. The flagship, formed in March 2005, was not. It could therefore not comply with the requirement to have directors and senior managers who collectively possessed appropriate expertise and experience in the management of its own business and that of its subsidiaries by the proxy of a non-existent subsidiary.

It was remiss of the appellant to rely on para. 7.2 of the OECD TPGs that has no application in Zimbabwe. But even if that para applied, the appointment of *inter alia* a subsidiary to conduct the head office functions would and cannot turn it into the head office. It merely remains an agent of the appointing entity from whom it derives its mandate and must constantly account for its conduct. The appellant turned the concept of agency on its head by making the flagship the holding company of the group. It further failed to demonstrate the normalcy of its conduct by way of empirical data. The means and manner in which the appellant effected the divestiture was abnormal. I am satisfied that the Commissioner's opinion in this regard was correct.

The alternative disjunctive, para (b) of s 98, is predicated upon the creation of abnormal rights or obligations that would not be created between parties dealing at arm's length. The arm's length principle is a universal one, which is concerned with the comparability of the actions of related parties with those of unrelated parties. Again, reference to para 1.1.1.0 of the guidelines was misplaced as it is not prescriptive but suggestive and is incapable predicting the multifaceted transfer pricing situations that may confront taxpayers and tax administrators.

The Commissioner correctly formed the opinion that the TOS in question created abnormal rights or obligations between the parties in that the appellant foisted its employment

obligations on the flagship. This was abnormal in that the relationship would not pass muster comparison with independent parties.

The further opinion that the avoidance, postponement or reduction of tax liability was the sole purpose or one of main purposes of the TOS

The respondent formed the further opinion that the divestiture of HO functions to the flagship had at the very least as one of its main purposes the avoidance or reduction of the appellant's tax liability. The appellant, through the testimony of JM, the Saint and the purported expert, asserted that the questions of tax was not in its contemplation. Rather, the main purpose was to free the directors of the appellant from the clutter and reputational risk associated with running an MNE, streamline management and engender growth of the appellant.

A company does not have a soul or body of its own. It operates through its directors in meeting. It is a peremptory requirement of s 138 of the Companies Act *[Chapter 24:03],* applicable at that time, that the board keep minutes of its deliberations. It was common cause the directors who conceived the divestiture did not keep minutes of their deliberations. It was again common cause that what passed for those minutes in the minute book of that time were the public resolutions flighted by the appellant in the media, which were all produced as exhibit 1A, 1B and 1C.

JM was not a director nor was he the company secretary of the appellant at the time the divestiture was conceived. The Saint was the GCEO and an executive director but was unsure whether the question of tax liability arose. Both witnesses conceded that at the time of divestiture the appellant was required to advise the respondent of the tax implications of the scheme, as it did during the 2018 dual listing of the appellant on the Botswana Stock Exchange. It is therefore highly unlikely that the tax implications of the divestiture would not have entered the mind of the appellant at the conception of the divestiture. I take the uncharacteristic uncertainty of the Saint as an admission that the implications of the divestiture on the tax liability of the appellant was one of the main reasons why the head office functions were housed in the flagship. In hindsight, the appellant actually avoided and therefore reduced its tax liability through this scheme. The further contention of the appellant that the TOS did not result in avoidance or reduction of tax by the appellant because such liability was absorbed by the flagship is both incorrect and irrelevant. It is incorrect because the flagship did not remit management fees that accrued from the management services rendered to it by the group employees to appellant. That would have altered the overall group tax matrix. It is irrelevant

because the appellant and the flagship were and are two separate and distinct taxpayers. See *GC (Pvt) Ltd* v *C-G Zimra* 2015 (2) ZLR 116 (H) at 133H-134A. The further opinion of the respondent in this regard was justified. It cannot be impugned.

The last leg of s 98 empowers the respondent to assess the appropriate tax liability of the taxpayer whose conduct falls into the purview of these jurisdictional factors. It reposes a very wide discretion on the respondent, which is designed to disgorge the errant taxpayer of the illicit tax gain. The Commissioner proceeded to do so in respect of management fees and royalties.

I proceed to assess the applicability of the s 98 jurisdictional facts to management fees.

Management Fees.

It was common ground between the parties that management fees accrued to the employer of the group personnel who rendered the management services. There are four glaring factors that show appellant had employees after 2005. The first was the letters of specific group employees it engaged through the hands of its most senior employees, the Saint, his successor and JM. The second was the profiling of the directors of the main and subsidiary boards in the post 2005 annual reports that referred to the main board as the group board[19]. The same annual reports listed the GCEO, GFD and all managing directors of the subsidiaries as group executives and eleven other group senior managers[20]. The third was the formation of the audit, remuneration and nomination board committees, which was inconsistent with a dormant board. Lastly, compliance with rule 4.6A of the local bourse's listing rules, which mandates that a listed company, such as the applicant, must have collective appropriate senior management expertise to run the group's business, whose expertise and experience must be disclosed in its listing documents. It was further common ground that the management fees were from a Zimbabwean source. It was also agreed that management fees accrued and were paid to the flagship. I have already found that housing the head office function in the flagship was a TOS that had the effect of avoiding or reducing the appellant's tax liability. The management fee income that accrued to the appellant was through this device designedly diverted to the flagship. I, therefore, find the first two jurisdictional facts confirmed.

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[19] Pp121-126 of respondent's bundle.

[20] Regional Development Manager, Group Research Manager, Group Technical Services Manager, Group Marketing Manager, Group Accounting Manager, Regional Internal Audit Manager, Group treasury Manager, Country Manager Kenya, Group Technical Manager, Group Processing Manager and Financial Director Zimbabwe.

Whether the means and manner of the diversion and recoupment was abnormal

The flagship charged the management fees that accrued to the appellant at cost. In the Appellant's Group Transfer Pricing Policy 2011/12, annexure B to its case, which attests appellant to be a ZSE listed company that is in business of breeding and marketing certified crop seeds with in country subsidiaries[21] the international transfer pricing consultant attributed the management fees to the appellant and warned it that the charges at cost were not compliant with the arm's length principle. In the same vein, the respondent formed the opinion that both the treatment and charge at cost were abnormal. The opinion was premised on the irrefutable fact that independent parties in the shoes of the appellant would have rendered the management services at a margin. The appellant did not dispute that the diversion was abnormal. Rather, it submitted that charging management fees at cost was normal yet curiously conceded that a mark-up is the commonly accepted way of earning a return on investment.

The appellant relied on the OECD TPGs, which preclude the grossing up of management costs, and the levying of duplicated services' costs and shareholder activity costs. The claim for costs for duplicative services and shareholder activities cannot be claimed under the OECD TPGs because they do not create direct commercial and economic benefit to the subsidiary. However, the flagship claimed and the subsidiaries paid the costs apportioned to them, which included shareholder and duplicative costs. The balance was apportioned to the flagship. JM testified that the flagship only recovered the actual costs expended by the group employees without marking them up because he feared that in-country revenue authorities would not have allowed the payment of grossed up fees. His fear, which was supported by the purported expert, was not supported by any concrete evidence. He produced no evidence to confirm the disallowance by these revenue authorities. The claimed fees were actual paid albeit to the wrong party. The appellant cannot therefore claim the benefit of OECD TPGs after the horse has bolted. In any event the management fees accrued to the appellant as the legal employer of all head office personnel. I am satisfied that the appellant failed to discharge the onus on it to show on a balance of probabilities that the opinion of the Commissioner that the diversion of income due to the appellant to the flagship and the failure to gross up the

[21] At p 239-18 of the pleadings bundle where external expert noted that "Appellant charges management fees to all the subsidiaries in the Group, except for subsidiaries that are currently in the incubation period of four years."

management costs incurred by group personnel was either conducted in an abnormal way or created rights or obligations between them that were abnormal was wrong.

Thus even if the OECD TPGs were applicable, the appellant would have failed to discharge the onus on it to show on a balance of probabilities that the purported duplicative and shareholding services did not create any direct commercial or economic benefits for all the subsidiaries in light of the avowed intention of the appellant to improve efficiency and promote growth within the subsidiaries.

The appellant was also entitled to receive management fees from the flagship, as the flagship was the chief beneficiary of the management services rendered by the Group personnel. The inclusion of the apportionment of the flagship in the computation of market related management fees that were re-positioned to the appellant was therefore appropriate.

The further opinion that the avoidance, postponement or reduction of tax liability was the sole purpose or one of main purposes of the TOS

The appellant denied ever diverting income to the flagship. It did not countenance the possibility that the Court would find that it did. It therefore did not address the point. At the very least I find against it that one of the main purposes of the diversion scheme was to avoid or reduce the tax liability of the appellant.

Whether the mark-up was justified

The respondent imposed a mark-up of 25% based on the average profit before tax of the appellant's reconstituted financial statements. The closing words of s 98 give the Commissioner a wide discretion in extirpating the avoidance or reduction. The appellant contended that the method was fundamentally flawed. The Commissioner simply imposed a blanket mark-up on the total head office costs, which included the costs that would have been incurred by the appellant, which was contrary to the OECD TPGs. The appellant relied on exh 11, compiled by the purported expert, which consists of three tables of the computation of management fees. The first shows that the management fees charged by the flagship were 58%, 33%, 27% and 60% higher in each respective tax year, than they should have been under the OECD TPG formula. The second showed that in comparison to those due under the OECD TPGs, the fees imputed to the appellant by the respondent were higher than they should have been had they been imposed on the flagship by 67%, 145%, 129% and 71% in each of the respective tax years. The last showed the total costs attributable to the subsidiaries, exclusive

of the flagship after deducting from the total head office costs, the costs pertaining to the flagship and shareholder costs. The tables attempted to show that the notional base amount upon which the respondent imposed the mark-up was too high, such that it produced an inequitable result.

I dismiss the contentions of the appellant for the following reasons. Firstly, the appellant deliberately ignores the purpose of the computation of the notional tax due from the miscreant taxpayer. It is to either correct the avoidance or reduction of its tax liability or to impose the appropriate notional tax.

In my judgment, in view of the provisions of s 143 (5), s 144 (1) and s 145 (1) of the Companies Act, *supra,* I hold the appellant to be synonymous with the Group. The Group achieved a profit before tax of 25% through the efforts of the group employees. The growth and profitability of the Group was the predominant responsibility of the appellant. The Commissioner was therefore entitled to use the average gross profit of the Group to mark-up the management fees. The Group itself was claiming management fees for all head office costs including the OECD TPGs shareholder activities. The Commissioner in the exercise of his extraordinary powers and untrammeled discretion correctly utilized the formula used by the appellant to claim management fees that accrued to the appellant at the mark-up she used in order for her to either collect the correct amount or disgorge the appellant of the illicit benefit. I, therefore find that the appellant failed to show on a balance of probabilities that the Commissioner's *quantum* of the tax liability was erroneous.

<u>Royalties</u>

Whether or not there was a transaction, operation or scheme and whether such transaction, operation or scheme had the effect of avoiding or reducing tax and was abnormal in the sense prescribed under s 98 of the Act.

The TOS in respect of royalties arose from the purported assignment of the five trademarks in question firstly from the appellant to the flagship and then from the flagship to SCI on the same day, 1 April 2005. JM represented the assignor and assignee in the first assignment and the assignor in the second in which the country manager represented the assignee. Until the case manager established by third party verification with the Zimbabwe

Trademarks Office that the appellant had never legally relinquished ownership[22], the appellant had maintained that they were owned[23] by SCI. By virtue of ss 26, 28, 29 and 30 of the Trade Marks Act, these trademarks are irrevocably owned by the appellant and protected from use by any competitor. The appellant thereafter took the position that the trademarks had no value on their own. The purported assignments constituted a TOS, the effect of which was to divest income accruing from the use of the trademarks from the appellant to SCI. The purported assignments made SCI and not the appellant the recipient of that income. The appellant divested itself of income due to it as royalties for which it should have been taxed. It therefore had the effect of either avoiding or reducing the tax liability of the appellant.

Whether the Commissioner's opinion that this TOS's way and means was abnormal or created abnormal rights or obligations was wrong.

The substance of the TOS was that SCI, earned income from the other subsidiaries based outside Zimbabwe from the use of the trademarks in question. It was common cause that the appellant characterised this income as royalties during the investigations in correspondence and meetings held with the case manager and in subsequent e-mails between and amongst JM and the country managers of its subsidiaries. In fact, the appellant never disputed in the 43 paged objection letter of 23 December 2013 that these payments constituted royalties. It only half-heartedly[24] did so in the appellant's case. However, the appellant implicitly conceded that the amounts paid for the use of the trademarks were royalties by accepting that the Research and Marketing Agreement, such as the one consummated between SCI and its Malawi subsidiary was a royalty agreement. In his unguarded moments during his long evidence in chief, JM also called the fees paid from such agreements royalties. He also explicitly did so in his letter to the case manager of 25 June 2013[25]. Indeed, the agreement is in the nature of a royalty agreement in that it requires the Malawi subsidiary to pay fees to SCI for the right to use research and marketing development intangibles of hybrid seed engineered by SCI as a percentage of the net sales of these products.

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[22] By third party verification letters from Zimbabwe Trademarks Office of 29 April 2013 and 14 January 2014, notwithstanding tax consultant letter to her of 28 May 2013 to pf p 87 of respondent's bundle that assignment legally completed in early 2013.

[23] By payment of renewal fees by SCI in E1-E7 of main bundle dated 23 February 2011 & 6 July 2012 of US$5 500 each, and 6 July 2012 of US$1 725 & 13 March 2013 of US$1 200 in Zimbabwe, 24 October 2011 in Zambia and 1 November 2011 in South Africa of US$ 3 170, 15 June 2012 of US$5 500 and 18 March 2013 of EUR 10 450 to ARIPO covering South Africa, Botswana, Kenya, Mozambique and Zambia Lesotho, Malawi, Swaziland, Tanzania, Uganda and Zimbabwe.

[24] By reference to prior without prejudice correspondence on the rate of and not in respect of liability for royalties of 28 May 2013 on p 300, 11 June 2013 p 200, 19 August 2013 p 246 (for progress sake) of main bundle.

[25] P394 and p 396 of the main bundle as a royalty and intangible related remuneration, respectively.

The appellant asserted during the investigations, in pleadings and oral testimony of JM and argument that only two agreements were consummated during the tax years in question. Of these two, only one was ever effected. The assertion is contrary to the position portrayed in the "Group Proposal to Review Transfer Pricing Framework" of 24 October 2013 produced by an international transfer pricing consultant fronted by Mr Erasmus, the lead representative of the appellant at the trial. These agreements were not availed to the case manager despite his requests, obviously because JM instructed his country managers not to cooperate with him as exemplified, firstly, by his e-mail of 26 June 2013 to the SCI country manager and secondly of 27 January 2014 to the managing directors of Tanzania, Zambia and Zimbabwe to fiddle the maize sales transactions between the three countries in order to minimize tax due to Zimbabwe from paying direct royalties of US$530 000[26]. I can only draw adverse inferences against the appellant for such unbecoming conduct.

It was common cause that only Zimbabwe and Zambia had research stations from which germplasm[27] was engineered and forwarded to the subsidiaries for trials. I understood the highly experienced scientist to have confirmed this position under cross examination. He had overall control and command of all research as demonstrated by his representation of the appellant in the agreement executed with CIMMYT in March and April 2004 for the benefit of SCI and thereafter his job description. That germplasm emanated from Zimbabwe was unwittingly confirmed by JM in his e-mail to the managing directors of Tanzania, Zambia and Zimbabwe of 27 January 2014. It emerged from the evidence of JM that the treasury function through which SCI accessed funds used by the other subsidiaries outside Zimbabwe, was based at the appellant's Harare Borrowdale head office. It was further common cause that the trademarked varieties and all the unpatented varieties from registered in country PBRs were sold under the general trademark for market recognition, reputation goodwill and quality consistence. It is clear to me that the wit, labour and intellect, and finances required to research, develop and market the two trademarked varieties and the rest of the unpatented PBRs bearing the general trademark originated from the appellant and not from SCI as captured in the SCI-Malawi agreement. See *Millin* v *CIR* 1928 AD 207 (3 SATC 170)[28].

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[26] The transaction involved misrepresenting that sale of hybrid seed of 20 metric tonnes from Zimbabwe to Tanzania had come from Zambia.

[27] Compared to pharmaceutical industry's "value in combination of products" in B1.4.5.5 of the appellant's case on p 85 of main bundle.

[28] Held that the source of royalties was the place where books were written (faculties of wit, labour and intellect) and not where they were published and copyrighted.

The assignments and subsequent royalty agreements created abnormal rights and obligations between the true owner of the trademarks-the appellant, SCI and the users. The true owner divested itself of the right to receive royalties from the users. The purported assignee was vested with the right to do so. The users were obliged to pay royalties to the purported assignee. These corporate incestuous relationships would not be undertaken by, and were therefore anathema to the conduct between, unrelated parties. Income from the use of trademarks would accrue to the true owner and the user would pay the agreed royalties to the true owner. The sacred rights and obligations conferred by ownership and utilization would be hallowed and not subverted by unrelated parties. It is my finding that the way and manner in which the TOS was consummated by the appellant and its subsidiaries was abnormal. I further find that the TOS also created abnormal rights or obligations between the appellant, SCI and its other in-country subsidiaries.

In the alternative, such an abnormal arrangement created abnormal rights or obligations between SCI and these subsidiaries in that royalties which accrued to the appellant were diverted to SCI. The conduct of the taxpayer fell into the impermissible second paradigm articulated in *CIR* v *King* 1947 (2) SA 196 (AD) at 210 and 216, 14 SATC 184 at 198 and 204" and to which *Commissioner of Taxes* v *Ferera* 1976 (2) SA 653 (RAD) at 659D-E cited in approval:

> "But the Commissioner would be properly aggrieved if a transaction or operation were entered into which prevented income from accruing to the taxpayer while leaving him in the position of one to whom the income would normally and naturally accrue.
> And
> Now normally and naturally the owner of an income-producing asset receives the income and the labourer receives the reward for his labour. Any departure from this order of things, if done with the object of prejudicing the *fiscus,* is the subject of the legitimate objection by the Commissioner, which is met by the machinery of the section."

I am satisfied that the income that was divested to SCI was in reality the income of the appellant. The Commissioner, therefore, correctly found the ways and means and in the alternative the rights or obligations created by the TOS in respect of royalty fees to have been abnormal.

The further opinion that the avoidance, postponement or reduction of tax liability was the sole purpose or one of main purposes of the TOS

I am unable to impugn the opinion of the Commissioner that one of the main purposes for embarking on such a TOS was to avoid or reduce the tax liability of the appellant. I, however, accept the other main reason for doing so was to benefit from the favourable

investment and capital raising laws in Botswana in 2005. However, that purpose lost its luster in the period of the tax review, which coincided with the introduction of a vibrant multicurrency regime and consequent creation of favourable macroeconomic policies in Zimbabwe.

The cumulative effect of the existence of a TOS and the two separate opinions of the Commissioner inevitably required her to implement the closing words of s 98. She was obliged to "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." The Commissioner could efficaciously do so with the cooperation of the appellant. The cooperation between the parties was exemplified by the Commissioner and appellant's acceptance to treat and use the SCI-Malawi agreement as the basis for calculating the imputed or notional royalties that were deemed to have accrued to the appellant. The purported "without prejudice" communication from the appellant must therefore be viewed in this light. The without prejudice communication cumulatively related to the computation rates and not to liability. As I have indicated elsewhere in this judgment, the question of liability was never disputed until much later. By then, the horse had bolted. The appellant's case had been crystallized by the position it adopted in its objection, which in tax disputes is the key pleading which freezes the rights which the Commissioner and later the Special Court for Income Tax Appeals can determine.

The appellant's fervent belief that the Commissioner was obliged to compute an arm's length notional royalty is not borne out by the closing words of s 98. All that is required of her is to assess, in her discretion, a figure that totally extirpates the TOS or one that takes away the illicit tax gain. This the Commissioner did by using the profit before tax figure for maize sales provided by the appellant. The appellant criticized it for including sales derived from other hybrid seed varieties. In my view, the criticism was unwarranted. I find the use of that formula to have been eminently sensible. This is because the general trademark was associated with all the hybrid seed varieties sold in country by all the subsidiaries and from which the Commissioner derived the gross profit.

The amended assessments issued by the Commissioner are therefore unimpeachable.

Penalty

The case manager first imposed a penalty of 100%, which he reduced to 75% on 2 August 2013. However in the assessment letter of 25 November 2013, he further reduced it to

60%. In the exercise of her s 62 (4) of the Income Tax powers the Commissioner increased the penalty to 100%.

In argument, Mr *Erasmus* wrongly contented that the Commissioner was not imbued with the power to alter the penalty imposed in the assessments. He wrongly sought to separate the penalty from the assessment. My view is that the assessment includes the principal amount, penalty and interest, which in any event was what the appellant had objected to. The power to impose a penalty befitting the offender, the offence and the interests of the community is reposed in the Commissioner by the overarching provisions of s 46 of the Income Tax Act, which inter alia hit any taxpayer who, inter alia fails to submit returns or submits incorrect returns as happened in the present matter.

Like the Commissioner, I am satisfied that the conduct of the appellant through its GFD was reprehensible. I am not persuaded that the appellant sought to apply the OECD TPGs in good faith at all. That conduct showed that the failure to render any tax returns on the part of the appellant was deliberately designed to defraud the revenue. In these circumstances the only befitting penalty is the maximum possible penalty provided by s 46, of 100%.

Accordingly I would, as I do hereby do, impose a penalty of 100%.

Costs

The grounds of appeal were not frivolous. I cannot therefore impose an adverse order for costs against the appellant. Rather, each party must bear its own costs.

Disposition

In the premises I make the following order:

1. The appeal be and is hereby dismissed in its entirety.
2. The amended assessments, numbers 1/699, 1/698; 1/697 and 1/700 issued by the Commissioner are confirmed.
3. Each party shall bear its own costs.

Atherstone and Cook, the appellant's legal practitioners