NOC (PVT) LTD
versus
ZIMBABWE REVENUE AUTHORITY

SPECIAL COURT FOR INCOME TAX APPEALS
ZIYAMBI AJ
HARARE,17 September 2019 & 26 November 2019

Income Tax Appeal

D. Tivadar, for the appellant
A. Moyo, for the respondent

ZIYAMBI AJ

[1] This is an appeal to the Special Court in terms of s 65 of the Income Tax Act [*Chapter 23:06*] ("the Act"). The appellant lodged two appeals under Case numbers ITC 14 & 15/17. These two appeals having been consolidated at the Pre-trial hearing, the issues which fall for determination are as follows:

1. Whether or not s 16 (1) (q) of the Income Tax ("the Act") (before it was amended by Act 1 of 2018) applied to interest payable in respect of arm's length third party borrowings.
2. Whether the appellant was entitled to treat staff meal expenses as being deductible in terms of the Act.
3. Whether the appellant was entitled to treat all the sums paid to various bodies as deductible in terms of the Act or whether this entitlement was restricted to the sums allowed by the respondent.

Background
[2] The respondent is an administrative body established in terms of the Revenue Authority Act [*Chapter 23:11*] and tasked, *inter alia*, with the collection of revenues due in terms of the Act. In 2016 -2017 the respondent carried out a tax audit/investigation into the affairs of the appellant in order to ascertain its tax compliance levels for the tax years 2012 to 2015. The audit established that the appellant had deducted certain expenses relating to loans, staff

lunches and sponsorships from its income when, in the respondent's view, these expenses are not deductible at law.

The respondent rectified the anomalies and, on the 21 April 2017, issued amended tax assessments to the appellant for the tax years 2012 to 2015. A penalty of 50% was also levied in terms of s 46 of the Act.

Pursuant to s 62 of the Act which allows an aggrieved taxpayer to object to an assessment made in terms of the Act, the appellant lodged an objection with the respondent on 29 May 2017. On 23 September, 2017, a determination was issued by the respondent disallowing, in full, all the objections save for the penalties relating to tax emanating from the disallowance of interest, which penalties were waived in full. The penalty on tax emanating from all the other disallowed expenses was maintained at 50%. Still dissatisfied, the appellant lodged an appeal to this court.

[3] With regard to the first issue, it is common cause that the appellant was, during the tax period under mention, loaned money by two foreign banks, namely, Export-Import Bank of China and KFW Bank in order to fund its operations. The loans accrued interest in the sums of US$2 591 093 and US$2 278 511. The interest thus accrued was one of the expenses deducted from the appellant's income but disallowed, in full, by the respondent.

Section 16 of the Act enumerates the cases in which no deductions are permissible. It provides in relevant part:

> **"16 Cases in which no deduction shall be made**
> (1) Save as is otherwise expressly provided in this Act, no deduction shall be made in respect of any of the following matters—:
> (a)- (p)
>
> (*q*) any expenditure incurred by a local branch or subsidiary of a foreign company, or by a local company or subsidiary of a local company, in servicing any debt or debts contracted in connection with the production of income to the extent that such debt or debts cause the person to exceed a debt to equity ratio of three to one (for the purpose of this paragraph, "equity" means issued and paid-up capital, unappropriated profits, reserves, realised reserves and interest-free loans from shareholders)."

[4] It was submitted by *Mr Tivadar*, on behalf of the appellant that s 16 (1) (q) was intended to limit only those loans that are received from companies by their shareholders. This is because firstly, the wording adopted by the legislature signifies that what the section was designed to catch are advances from a parent company or a 'deemed' parent company (such as a local branch of a foreign company); secondly, the only conceivable legislative intention behind s 16

(1) (q) is to act as an anti-avoidance measure in that it prevents shareholders from 'dressing up' capital contributions as if they were loans. If that were not so, the taxpayer company and its shareholders may be able to reduce tax liabilities by lowering the taxable income of the company; thirdly, if the respondent's interpretation of the section was to be adopted, highly geared business ventures would be 'disincentivised' in Zimbabwe because the tax regime, on that view of things, would penalise those companies that borrow from third party lenders rather than raising equity. This is especially important in the case of the appellant who is a state-owned entity and cannot raise equity capital the same way as a private company could; fourthly, on the respondent's interpretation, a company that accumulated losses resulting in the reduction of its equity would end up having increased tax liability when borrowing the same amount from unrelated third party lenders. In other words, the more a company needs debt financing, the higher its tax burden would become.

[5] *Mr Moyo*, on the other hand, urged the court to be guided by the clear wording of the statutory provision. This, he submitted, is the approach followed in the interpretation of taxing Acts. He referred the court to the matter of *CW* v *Commissioner of Taxes* 1988 (2) ZLR 27 (HC) at 35-36 where the Court clarified the method of interpretation to be followed in taxing Acts.

He submitted further that the language used in s 16 (1) (q) clearly prohibits the making of any deduction in respect of any expenditure incurred by a local company in servicing any debt or debts contracted in connection with the production of income to the extent that such expenditure exceeds a debt to equity ratio of three to one. Besides, nowhere in the section is it stated or implied that interest from third party loans is not meant to be covered by the section.

[6] In my judgment, there is merit in *Mr Moyo's* submissions. As *Mr Tivadar* submitted, the point of disagreement between the parties is whether or not the limitation set out in the section applies where the loans are received from non- shareholder third parties. The appellant contends that it does not whereas the respondent maintains that it does.

In view of the plain wording of the statute, I must disagree with the submissions made by *Mr Tivadar*. The words employed by the statute are clear and unambiguous. "*A local company ..or its subsidiary*". Nothing could be clearer. The appellant is a local company. Where the wording of a statute is clear and unambiguous there is no reason to debate the intention of the legislature unless adhering to the clear intention would result in an absurdity. No absurdity has been alleged and I see none. The next step is compliance with the clear provisions of the statute.

I would determine this issue in in the affirmative and in favour of the respondent.

Whether the appellant was entitled to treat staff meal expenses as being deductible in terms of the Act.

[7] The appellant contended that the staff meals concerned were necessarily incurred for the purpose of trade in accordance with the provisions of s 15 (2) (a) of the Act. The section, in relevant part, is quoted hereunder.

> "**15 Deductions allowed in determination of taxable income**
>
> (1) For the purpose of determining the taxable income of any person, there shall be deducted from the income of such person the amounts allowed to be deducted in terms of this section….
> (a)..(c)..
> (2) The deductions allowed shall be—
> (*a*) expenditure and losses to the extent to which they are incurred for the purposes of trade or in the production of the income except—
> (i) to the extent to which they are expenditure or losses of a capital nature; or
> (ii) expenditure that constitutes prepayment for goods, services or benefits that will be used up in any subsequent year of assessment (in which event the expenditure will be allowed proportionately over the years of assessment in which the goods, services or benefits are used up)."

It was common cause that unless the appellant could show that the meals were provided for consumption by the employees while they were on duty, the meals were regarded as entertainment and were not deductible. The appellant therefore set out to prove the factual issue, namely, whether the meals were consumed during working hours by the employees when they had to be, and were, on duty.

[8] The appellant called, as its only witness, its manager, financial control responsible for expenditure. He drew attention to a document forming part of the papers which he described as an extract 'from our financial reporting statement'. He said that this document contains a list of payments done towards staff lunches. He explained that members of staff were entitled to reimbursement or advancement for lunch dinner or teas if they worked during lunch hour, tea time or after 7 pm. The same applied if they worked on weekends until after 12 p.m.

On p 2 of the document was a request for funds for the Finance director. He was given an appropriate amount every month for hosting visitors to his office. The remaining pages contained requests for disbursements for staff training, morning meetings and the actual disbursement vouchers. He agreed that the supporting documents did not show the times worked by the employees, for example, whether in fact the employees worked say from 10-10.30 am or from 1-2 pm. Indeed, it was his evidence that the documents produced 'did not

capture everything'. That was the gist of his evidence. The witness did not profess any personal knowledge of the details of the case.

[9] In the final analysis the appellant, apart from his mere say so, has not adduced evidence which would prove that it was necessary for the employees to be at work during their lunch or tea breaks nor did it establish that they did in fact work during those times. As Mr *Moyo* submitted, the factual situation alleged by the appellant was not proved. In the circumstances I have to find that the appellant has not discharged the burden of proof, which it bears, to prove that the assessment by the respondent was wrong. This issue is determined in favour of the respondent.

Whether the appellant was entitled to treat all the sums paid to various bodies as deductible in terms of the Act or whether this entitlement was restricted to the sums allowed by the respondent.

[10] This issue is concerned with the sponsorship agreements concluded by the appellant with various sporting bodies during the tax period concerned. The essence of the agreements was that the appellant would pay, to the sponsored body, an agreed sum of money which would cover the costs of payment of branded club kits, accommodation and meals for participating teams during camping, payments to match officials, medals, trophies, prize money and 'welfare for journalists'. In return, the sponsored body would give certain rights to the appellant which rights included placement of the appellant's logo on the team kits and the erection of banners and other advertising material at the field during matches. The cost of erection of the banners and other material at the field was not part of the sponsorship fee but was an additional cost to the appellant. During the tax years 2012 - 2015, the appellant deducted against income, the expenditure incurred in connection with the sponsorships. In its assessment, the respondent allowed as a deduction the expenses incurred on what it considered to be 'actual marketing and advertising activities such as branded kits'. The additional expenses incurred on direct sponsorships were disallowed.

The appellant objected to the assessment on the grounds that the Commissioner disregarded the fact that the sponsorship expenses were marketing expenses which enhance the brand of NOC nationally and internationally and were therefore incurred for the purposes of trade or in production of income thus rendering them deductible in terms of s15 (2) (a) of the Act which provides as follows:

"(2) The deductions allowed shall be—

(a) expenditure and losses *to the extent to which they are incurred for the purposes of trade or in the production of the income* …" (Emphasis provided)

[11] The above gives rise to the question whether the disallowed expenditure on the sponsorships were incurred for the purposes of trade or in the production of income.

The appellant asserted that the sponsorship expenses (in respect of the agreements with the various bodies like PSL, ZIFA, Tennis Association of Zimbabwe and other bodies) were incurred with the objective of advertising and marketing its business products and as such the expenditure was incurred for purposes of trade and deductible in terms of the Act. It explained that NOC has an aggressive marketing strategy which involves entering into strategic alliances with various sporting disciplines. The sponsorship packages, which can include provision of medals and trophies, clubs' kits, prize moneys, provision of accommodation and meals for camping, payments to match officials and travelling costs to matches, are in essence all part of the marketing and promotional activities for the purpose of its business and are therefore deductible in terms of s 15 (2) (a) of the Act.

Mr *Tivadar*, who appeared on behalf of the appellant, submitted that given the respondent's acceptance that to the extent that the appellant advertises its services at a sporting event, the cost of that advertisement is deductible, the entire amount spent on the sponsorships ought to be deductible for, if there is no sporting event, there is no advertising opportunity for the appellant. The respondent's attempt to separate the different aspects of a single agreement is highly artificial and designed to ensure that the appellant cannot reduce its tax liabilities.

He dismissed the respondent's assertions that the sponsorships were donations alternatively expenditure of a capital nature both of which were not deductible in terms of the Act, claiming that neither the characteristics of donations nor those of expenditure of a capital nature were present in any of the sponsorships.

[12] The respondent submitted that the additional expenses, including accommodation and meals for participating teams during camping, payments to match officials, provision of medals trophies prize money and 'welfare for journalists' did not constitute advertising or marketing. In order to constitute advertising and advertisement should contain comparative or qualitative descriptions of advertiser's products, services facilities or addresses. The mere use of the appellant's name, logo or products did not constitute advertising or marketing. It was emphasised that the erection of banners and advertising material were not included in the sponsorship amounts paid by the appellant but on the contrary the appellant was required to pay for 'actual advertising' thus demonstrating that the sponsorship activities alone did not

constitute marketing or advertising. Further, the disallowed sponsorship expenses were not, contrary to the appellant' s assertions, incurred for the purposes of trade in the production of income. They were not necessary for the performance of the appellant's business operation and were not incurred for the more efficient performance of the appellant's business operation. Accordingly, the said expenses were not incurred in the production of income and thus fell outside the ambit of s 15 (2) (a) of the Act. Instead, the expenses were merely donations which are not allowable deductions under our law unless the specific criteria detailed in ss 15 (2) (r) – s 15 (2) (r5) of the Act is met. Alternatively, if the appellant's submissions that the sponsorship agreements would give to them certain marketing rights, this meant that the sponsorships bought the appellant the rights to be able to advertise. The expenditure thus ceased to be of a revenue character and became one of a capital nature.

[13] Section 63 of the Act provides as follows:

"63 Burden of proof as to exemptions, deductions or abatements

> In any objection or appeal under this Act, the burden of proof that any amount is exempt from or not liable to the tax or is subject to any deduction in terms of this Act or credit, shall be upon the person claiming such exemption, non-liability, deduction or credit and upon the hearing of any appeal the court shall not reverse or alter any decision of the Commissioner unless it is shown by the appellant that the decision is wrong."

The appellant bears the burden of proving the disallowed sponsorship allowances are 'expenditure incurred for the purposes of trade or in the production of income', are not liable to tax in that they were deductible in terms of s 15 (2) (a), and that the Commissioner's decision is wrong.

In *Commissioner of Taxes* v *Rendle* 1965 (1) SA59 at p 61, BEADLE, CJ gave certain guidelines. The issue presented to him for determination was whether certain expenditure (monies paid to two companies because of embezzlement by an employee) could be regarded as wholly and exclusively incurred by the respondent for the purposes of his trade and therefore deductible in terms of s 13 (2) (a) of the Income Tax Act 1954, as amended, which provided that the deductions allowed shall be-

> "expenditure and losses (not being expenditure and losses of a capital nature) wholly and exclusively incurred by the taxpayer for the purposes of his trade or in production of the income;"

At p 60 of the judgment he said:

> "For the purposes of this case, expenditure incurred for the purpose of trade may be grouped broadly under two heads. First, money voluntarily and designedly spent by the taxpayer for the purpose of his trade; and second, money which is what I might call involuntarily spent because of some mischance or misfortune which has overtaken the taxpayer. For the sake of convenience, I

> will refer to the first type of expenditure as "designed expenditure", and to the second as "fortuitous expenditure".

And at p 61:

> "The deduction of designed expenditure (so far as the law is concerned) presents no difficulty. Provided it is designedly and *bona fide* incurred wholly and exclusively for the purpose of trade, it is deductible, no matter how rash or unnecessary the expenditure might be. It is not for the Commissioner to direct how a taxpayer should run his business."

[14] It seems to me the sponsorship payments in this case fall within the category of what the learned Chief Justice termed 'designed expenditure.' There is nothing on the papers to gainsay the appellant's assertion that the sponsorship payments were incurred for the purpose of trade. The appellant has denied that the payments amount to capital expenditure. I agree. The payments do not meet the tests set out on *RENDLE's* case, *supra*. They were stated by BEADLE CJ at p 65 of the same report as follows:

> "Two of the generally accepted tests in deciding whether an expenditure is a capital or an income expenditure are:
> Was the expenditure a "once and for all" expenditure or one which was likely to re-occur? See the remarks of Lord Dunedin in the *Vallambrosa Rubber Co*. v *Farmer*, 1010 SC 519 at p 524; or whether or not the expenditure was made with a view to bringing into existence an asset for the enduring benefit of the trade. See *British Insulated and Helsby Cables Ltd* v *Atherton*, 1926 AC 205 at p 213."

As Mr *Tivadar* submitted, there was no once for all expenditure or expenditure made with a view to bringing into existence an asset for the enduring benefit of the trade. Further, I agree with his submission that once it was accepted by the Commissioner that certain aspects of the sponsorship payments were deductible in that they constituted advertising, that put an end to the matter. In my view it was improper to split the payments into segments some deductible and some not deductible. As submitted on behalf of the appellant, acceptance that some parts of the agreement would constitute advertising would necessarily include acceptance that the sponsored events would have to take place in order for the advertising to come about.

[15] In the circumstances, I am of the view that the appellant has discharged the *onus* of showing, on a balance of probabilities, that the Commissioner erred in this regard.

This issue is therefore decided in favour of the appellant. The matter will be remitted to the Commissioner for the purpose of making an amended assessment in keeping with this judgment.

[17] Accordingly it is ordered as follows:

1. The appeal is allowed in part.
2. The assessment in relation to the sponsorships is hereby set aside.

3. The matter is remitted to the Commissioner for making an amended assessment in keeping with the terms of this judgment.

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