REPORTABLE ZLR (35)

Judgment No. SC 31/06
Civil Appeal No. 323/04

BARCLAYS BANK OF ZIMBABWE v

ZIMBABWE REVENUE AUTHORITY

SUPREME COURT OF ZIMBABWE
CHEDA JA, ZIYAMBI JA & MALABA JA
HARARE, FEBRUARY 20 & SEPTEMBER 25, 2006

J Mafusire, for the appellant

L Mazonde, for the respondent

ZIYAMBI JA: The appellant is a Commercial Bank which carries on business within Zimbabwe. On 23 October 2001, the respondent, as the authority responsible for the collection of revenue in Zimbabwe, served a garnishee order upon the Reserve Bank of Zimbabwe requiring that bank to pay to the respondent, by way of taxes, the sum of $301 572 750.05 from the appellant's account with the Reserve Bank. Thereafter, on 6 November 2001, the garnishee was effected. Part of the funds represented employees' tax ("PAYE") which the respondent claimed ought to have been withheld by the appellant from the employees for payment to the respondent.

In the High Court, the appellant brought a court application seeking, *inter alia,* a *declaratur* that:

> "No taxable benefit accrued to the employees of the applicant as at the date of exercising rights in terms of the management share option scheme, and accordingly that the applicant was not obliged to withhold any employees' tax in respect of the exercise of such options";

and, an order that the respondent repay to the appellant the sums garnished from its account with the Reserve Bank.

This appeal is against that part of the judgment of the High Court in which it found, in favour of the respondent, that a taxable benefit did accrue to the employees at the time of the exercise of their rights in terms of the management share option scheme.

The management share option scheme ("the Scheme") was set up by the appellant to grant to its managerial employees options to purchase its shares within a certain period at prices ruling at the time of the grant of such options thereby giving, to the employees, preferential rights of allotment commensurate with their seniority within the bank. The purpose of the scheme was to provide further incentives for motivating and retaining managerial staff for the benefit of the bank. The number of shares allocated to the scheme constituted 1.5% of the issued share capital of the bank and was to be maintained at that level at all times. The option price payable on exercise of the option was the middle market price prevailing on the day immediately prior to the day on which such option was granted. The options were not transferable and were to expire:

(a) when the employee's employment was terminated whether through resignation or dismissal;

(b) upon demotion of the participant to a grade lower than that of manager;

(c) at the lapse of 12 months from the date on which the participant retired from the bank's service after reaching normal retirement age; and,

(d) upon the expiry of 10 years from the date on which the option was granted.

The option was to be exercised by way of a written notice signed by the participant and stating the number of shares the participant wished to take. The date on which the bank received the notice was deemed to be the date on which the option was granted.

The appellant contended that because the grant of the share options was unconditional and the employees were entitled to use their discretion as to when to exercise the options, the taxable event was to be determined by reference to the share option price and the middle market value of shares ruling at the date of granting the option. Thus, if the prices were the same, there would be no taxable event. While accepting that the subsequent rise in the value of the shares between the dates of granting and exercising the share options was a benefit to the employees, the appellant denied that the benefit thus obtained was a taxable benefit in terms of ss 8(1)(b) or 8(1)(f) of the Income Tax Act [*Cap 23:06*] ("the Act"), for which the appellant was obliged by virtue of paragraph 3(1) of the Thirteenth Schedule to the Act, to deduct PAYE as opposed to a capital gains tax liability taxable in the hands of the employee.

It was further contended by the appellant that since the Act does not specifically deal with share options, regard should be had to the case law developed over the years in particular the English case of *Abbott v Philbin* (1960) 2 All E.R. 763 (HL) and the South African case of *Mooi v Secretary For Inland Revenue* (1972)(1) SA 675 (A).

The respondent's stance was that the grant of the option was conditional as seen from the fact that the options were not transferable, they lapsed automatically upon resignation or dismissal, and they were granted: upon promotion of employees to managerial level, in recognition of services rendered or as an inducement to render future services to the bank. Accordingly, so it was argued, the provisions of s 8(1)(b) and (f) of the Act are applicable in these circumstances in that there was an accrual of an advantage with an ascertainable money value at the time of exercising the offer.

The respondent further submitted that the case of *Abbott & Philbin* was not applicable as the facts therein differed materially from those in the instant case and that there existed the necessary "casual relationship" between the benefit acquired by the employees and their services to the bank to bring the benefit within the statutory definition of gross income. See *De Villiers v Commissioner for Inland Revenue* 1929 AD (229) 233.

The relevant provisions of the Act are set out hereunder:

"**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:

(a) … .

(b) any amount so received or accrued in respect of services rendered or to be rendered, whether due and payable under any contract of employment or service or not, and any amount so received or accrued by reason of the cessation of the employment or service of a person other than a benefit (not being a pension or gratuity) received or accrued by reason of contributions made to the Consolidated Revenue Fund, and any amount so received or accrued in commutation of amounts due under a contract of employment or service.…

(c) ….

(d) ….

(e) ….

(f) an amount equal to the value of an advantage or benefit in respect of employment, service, office or other gainful occupation or in connection with the taking up or termination of employment, service, office or other gainful occupation:…

For the purposes of this paragraph -

1. 'advantage or benefit'-

   (a) means-

      (i) …

      (ii) …

      (iii) …

      (iv) the use or enjoyment of any other property whatsoever, corporeal or incorporeal, including a loan, …";

There is no doubt that the share options were granted, in respect of services rendered, to those who had rendered satisfactory service to the bank and were promoted to the rank of managers and, in respect of services to be rendered, to all managers including new managerial appointees. The appellant says that the scheme was an incentive to them. Assuming the share options were exercised on the day of grant of the options there would be no profit accruing to the employee. However, as the options were exercised at a later date when the value of the shares at the date of the exercise of the option had risen, the difference between the option price and the actual value of the shares would be a profit to the employee and constitute a benefit. That much was conceded by the appellant who maintained, nevertheless, that the benefit so obtained does not fall within the definition of remuneration in paragraph 1(1)(b) of the Thirteenth Schedule of the Act and accordingly that there was no obligation on the appellant to deduct PAYE therefrom in terms of paragraph 3(1) of the said Schedule.

What in fact occurred upon exercise of the share options is that when notice was given to the bank, in terms of the conditions of the scheme, that the employee wished to exercise his option in respect of x number of shares, the appellant sold x shares on behalf of the employee, deducted from the proceeds thereof the price of the shares (the option price in terms of the scheme) and paid the balance to the employee. That was a profit obtained without the employee having to make any out-of-pocket payment. It is this profit which the appellant claims is not taxable in the employer's hands while the respondent maintains that it is an amount equal to an advantage or benefit in respect of employment, service, office or other gainful occupation in terms of s 8(1)(f), and an amount received or accrued in respect of services rendered or to be rendered in terms of s 8(1)(b) of the Act.

In my view the respondent is correct. The provisions of the Act aforesaid are clear and unambiguous and the amounts accrued to the employees fall within the provisions of both the said paragraphs.

It was submitted by the appellant that the cases of *Abbott v Philbin & Mooi, supra,* are authority for the proposition that the share option itself was the thing granted to the managers as a perquisite of their employment; that it is a thing which could be turned to some value; and that the date of the grant of the option was the date on which it should be taxed. If the value of the shares at the date of grant of the option was different from the share option price offered to the employee then the difference would be

taxable. However, as in this case there was no difference, the option price being the mid market price of the shares, there was nothing to be taxed.

The decisions referred to, though not binding on this Court would of course be persuasive authority which could assist this Court in arriving at a decision in the instant matter. But, as it was put by RUMPFF JA in *Mooi*'s case, *supra*, at p 686, referring to the decision in *Abbott v Philbin*:

> "What does persuasive authority mean? In my view certainly not the mere final order of that Court, but the force and validity of the reasoning upon which the order is based."

In that event, I am persuaded by the reasoning of DENNING LJ in *Abbott v Philbin*, *supra*, in his dissenting judgment at p 777F – 778C, where he stated as follows:

> "Now in *Salmon v Weight* that case shows decisively that the expectation of receiving a benefit, no matter how well founded is not itself a perquisite or a profit. It must be reduced into possession. A bird in the hand is taxable, but a bird in the bush is not. So, here, if nothing had been paid for the option, the letters that passed would have been no more than a standing offer by the company to allot shares to the appellant at 68s. 6d. a share. That offer could have been withdrawn by the company, at any time before acceptance, with impunity. The offer itself would not be a perquisite or profit, for it conferred only the expectation of the profit, not any profit itself. But, when it was accepted and shares worth 82s. apiece were allotted to the appellant for 68s. 6d., he would then receive profits which would be taxable in his hands. No difficulty would arise about the year of assessment. The profits would accrue to him in the year they were received.
>
> … I ask myself what is the difference between the case I have just put, where nothing is paid for the option, and the case we have before us, where a nominal sum is paid? The difference is that in the one case he has only an expectation of profit whereas in the other he has a right to make profits in future, if the

> opportunity arises. But in either case, until the option is exercised, he has not the profits themselves. And, as I read the Act, it is not the expectation to make profits, nor the right to make profits, which is taxable, but only the profits themselves. Just as it is not the expectation to salary nor the right to salary which is taxable, but only the salary itself. A bird in the bush is not taxable if it is still there. You must have it in hand before you can be taxed for it. And when you come to consider what 'profits' the servant receives from his employment by virtue of the option, surely it makes no difference whether he pays a nominal sum or not. In either case the employer grants him the option as a reward or return for his services; and the profits he makes out of it are the same save for this: if he paid nothing, it is all profit: if he paid a peppercorn, it is all profit less the value of a pepper berry; if he paid 1s., less a 1s., if he paid £20, less £20."

It follows from the above that I do not accede to the submission made on behalf of the appellant that no taxable event occurred upon the exercise of the share options by the employees. Rather, I take the view that upon the grant of the option, the employee receives a mere expectation to make a profit from the shares. Once he exercises the option and receives the shares, their value, less any amount paid for them before or upon exercise of the option, is taxable in terms of para 3(1). The argument that the employee received, at the time of the grant of the option, an offer which could be turned to monetary value does not assist the appellant. The option was not transferable. In any event, until he exercised the option there was nothing to transfer but an expectation which would in this case be valueless.

Accordingly, the judgment of the court *a quo* is upheld and the appeal is dismissed with costs.

CHEDA JA: I agree.

MALABA JA: I agree.

Scanlen & Holderness, appellant's legal practitioners

Kantor & Immerman, respondent's legal practitioners