PAPERHOLE INVESTMENTS [PVT] LTD
and
PROFEEDS [PVT] LTD
versus
ZIMBABWE REVENUE AUTHORITY

SPECIAL COURT FOR INCOME TAX APPEALS
MAFUSIRE J
HARARE,

Date of judgment: 10 February 2025

Income tax appeals

No appearance
Judgment on the papers

MAFUSIRE J

[1] These are two appeals which, by agreement of the parties at the pre-trial hearing [PTH], would be determined together because of the similarities of the issues. No facts were in dispute. Therefore, *viva voce* evidence was dispensed with. The parties filed a very concise statement of agreed facts.

[2] The appellants, Paperhole Investments [Pvt] Ltd [“***Paperhole***”] and Profeeds [Pvt] Ltd [“***Profeeds***”], appealed to this court against certain of the respondent’s decisions disallowing their objections to some assessments or re-assessments of their income tax obligations.

[3] Paperhole is in the business of sourcing, financing, logistical management and delivery of agricultural commodities and their inputs. Profeeds is in the business of manufacturing animal feed, including poultry, cattle, horse, pig, rabbit, and goat feed.

[4] From their activities, the appellants earn revenue in both local currency and foreign currency, primarily the United States dollar. The appellants’ operations and capital

expenditure, which generate the local and foreign currency revenues, are incurred in both local and foreign currency.

[5] The appellants, a company called Progroup Holdings [Pvt] Ltd [“***Progroup***”] and Innscor Africa Ltd [“***Innscor***”] are associated or related entities. Innscor is a diversified conglomerate, operating as a management holding company for its subsidiaries and associate companies including the appellants. Profeeds is a subsidiary of Progroup.

[6] Profeeds entered into service level agreements with Innscor and Progroup respectively for the provision of management services [with Innscor] and for the provision of corporate head office management support services [with Progroup].

[7] The tax periods in dispute were 2019 and 2021 in respect of Paperhole, and 2016 to 2021 in respect of Profeeds. The appellants submitted their income tax returns for these years within the stipulated submission deadlines and tendered payment in the local currency.

[8] The respondent carried out audits on the appellants in respect of those years. The respondent made the finding that the appellants were liable to pay tax in foreign currency for those years by reason of the fact that s 4A[1][c] of the Finance Act [*Chapter 23:04*] [“***the Finance Act***”] obliges taxpayers to pay tax in foreign currency on taxable income generated in foreign currency.

[9] The respondent held that the appellants were supposed to have calculated the tax payable and apportion it in the respective currencies using the exchange rates prevailing at the quarterly payment dates [QPDs] as guided by the respondent’s Public Notice 26 of 2019.

[10] Furthermore, the respondent disallowed the deductions claimed by Profeeds in respect of the management fees it had paid to Progroup as not being deductible under s 15[2] of the Income Tax Act [*Chapter 23:06*]. It held that those fees were mere budgeted costs and that expenditure that should properly be deducted under s 15[2] should be expenditure ‘***incurred***’.

[11] The respondent also held that Profeeds had failed to demonstrate that actual 'services' had been rendered and that, at any rate, Profeeds itself had sufficiently well trained and skilled personnel who could perform the same or similar functions as those allegedly rendered by Progroup in respect of the service level agreement.

[12] Having made those findings, the respondent levied a penalty of 20% against Profeeds allegedly for overdue income tax.

[13] The appellants disputed the respondent's findings. The respondent proceeded to issue to Paperhole an income tax assessment shortfall amounting to US$11 290-80 in respect of the 2019 tax year, and USD1 134 203-06 in respect of the 2020 tax year. It also issued to Profeeds an income tax assessment amounting to US$2 265797-34 in respect of the 2019 to 2021 tax years and ZWL94 662 297-27 in respect of the 2016 to 2021 tax years.

[14] Pursuant to the provisions of s 65 of the Income Tax Act, the appellants lodged their objections with the respondent. The objections were dismissed. Aggrieved, the appellants separately appealed to this court.

[15] The appeals were set down for a PTH and subsequently referred to trial on the issues as set out on the Joint PTH Minute.

[16] The parties filed very detailed heads of argument. On the whole, the documents drafted by both parties were so long. Some issues were repeated *ad infinitum*, even those dealing with mere foundational principles, for example, the *contra proferentem* rule of interpretation. It has been cumbersome and quite taxing to read acres and acres of interminable documents.

[17] The main issue for determination was whether the appellants were liable to pay income tax in foreign currency in respect of the income that they had earned in foreign currency during the tax years 2019 to 2020.

[18] In respect of Profeeds, the issues for determination specific to it were, in my paraphrase:

- whether it had submitted sufficient proof that the management fees that it paid to Progroup under the service level agreement had been incurred, and therefore an allowable deduction under s 15[2] of the Income Tax Act, and
- whether the 20% penalty was justified.

[19] In argument, some of those issues might have splintered into several facets. But the substantive disputes were those set out above. They are now considered in turn.

[*a*] *Whether the appellants were liable to pay income tax in foreign currency during the period 2019 to 2020 in respect of income earned in foreign currency*

[20] The appellants argued that the respondent did not have the legislative back up to require them to submit two separate returns, one in local currency and the other in foreign currency. They also argued that by its Public Notice No 26 of 2019 aforesaid the respondent was unlawfully arrogating to itself legislative functions in order to cover a lacuna in the law.

[21] However, as the respondent argues, the issues whether in terms of the legislation as it existed at the relevant time the respondent could require tax payers to pay income tax in foreign currency in respect of income accrued in foreign currency; whether the respondent was correct to require two separate returns for the local and foreign currency components of the tax; whether the respondent's Public Notice No 26 aforesaid is unlawful, and so on, are well trodden paths.

[22] Indeed these aspects are issue estoppel. The approach by appellants' counsel are cumbersome. They recycle the same arguments by themselves and others in previous cases.

[23] The fiscal courts have since ruled in a number of cases before, that companies whose income comprises a component in foreign currency should pay tax in foreign currency on any such component of the foreign currency; that it was not wrong for the respondent to require two separate returns in respect of the different currencies; and that Public Notice 26 aforesaid was not legislating by the respondents through the back door, but rather, mere advice. Reference is made to the cases of, among others,

Delta Beverages [Pvt] Ltd v ZIMRA HH577-23 and *Redan Petroleum [Pvt] Ltd v ZIMRA* HH673-23. The position can now be considered settled.

[24] The issue relating to the applicable rate of exchange on QPDs was exhaustively covered in the *Redan* case above. The rate applicable is that prevailing on the QPDs, and not the one at the end of the tax year.

[*b*] *The deductibility of the management fees paid by Profeeds to Progroup*

[25] The appellants have argued on multiple grounds that it was wrong for the respondent to have disallowed the management fees paid by Profeeds to Progroup under the service level agreement.

[26] A significant portion of the argument by both parties centred on the meaning of the word 'i***ncurred***' as used in s 15 of the Income Tax Act.

[27] For context, in s 15[1] of the Income Tax Act, a taxpayer is allowed to deduct from their income, certain types of amounts in order to arrive at their taxable income. Section 15[2] then goes on to specify those allowable amounts. The first, in para [a], are amounts of expenditure and losses to the extent to which they are ***incurred*** for the purposes of trade or in the production of the income, except those exempted.

[28] It is another well-trodden path what meaning is ascribed to the expression "… ***to the extent to which they are incurred for the purposes of trade or in the production of the income*** …"

[29] It is now settled that the expenditure referred to in the above provision must actually have been incurred. In respect of service level agreements, a common phenomenon of most multinational companies and their associates or subsidiaries, the services in question must actually have been rendered: see *CF [Pvt] Ltd v ZRA* HH 99-18 and *Nestle Zimbabwe [Pvt] Ltd v ZRA* HH236-24.

[30] A service charge between associates has to be consistent with the arm's length principle of s 98 of the Income Tax Act. In terms of Para 8 of the Thirty-Fifth Schedule to that Act, such a service charge is consistent where, *inter alia*, it is charged

for a service that is actually rendered; the service rendered provides the recipient with economic or commercial value to enhance its commercial position, and it is charged for a service that an independent enterprise in comparable circumstances would have been willing to pay for [*underlining for emphasis*].

[31] In the view of this court, whether a management fee is payable by one associate company to another associate company is very much a question of fact. The law is settled. The deductibility depends on the special circumstances of the case, taking into account the nature of the agreement creating the entitlement to receive, and the obligation to pay the fee; the agreement in regards to the manner of activating the obligation to pay, like invoices, for example; how the services were actually rendered and consumed on the ground; the manner of generating the payment, and so forth. All these are matters of fact.

[32] The argument advanced on behalf of Profeeds that it is common place for a deduction to be made and claimed in terms of s 15[2] of the Income Tax Act even where no service has been rendered but for as long as there is an unconditional liability to pay, and that a management fee such as the one in question is a common fixed fee contract akin to contracts of insurance, medical aid contributions or subscriptions, retainer fees for lawyers, and so on, are, with all due respect, way off the mark.

[33] As pointed out earlier, proof of the actual service rendered has to be submitted. This kind of fee is different from Profeeds' examples of comparable expenditure. With insurance, for example, the service is provided in the form of the cover provided. Medical aid contributions are expressly covered in s 15[2][j] of the Income Tax Act. Subscriptions to professional or trade associations are covered under s 15[2][s] of that Act. Retainer fees are allowable only if the service has been rendered.

[34] As said, it is a question of fact whether or not the service was rendered. Profeeds said it furnished the respondent with sample evidence of the actual work done by Innscor and Progroup. It is said that this was in the form of emails, memoranda, and documents showing the strategic meetings held, monthly business review meetings, tax services, training, legal and company secretarial services rendered, and so forth.

[35] In view of the law on transfer pricing, and the arm's length principle, the respondent is justified to scrutinize any agreements, arrangements and practices to ensure compliance.

[36] However, the respondent should not demand absolute proof or proof beyond a reasonable doubt that the expenditure claimed for the deduction was incurred. It is the considered view of this court that in the present case, the respondent should have accepted the evidence referred to above tendered by the appellants as proof that the services in question were rendered, and therefore incurred, and therefore deductible. Its decision to disallow the expenditure for the purposes of s 15[2] of the Income Tax Act is liable to be set aside.

[*c*] *Duplicated service*

[37] The respondent disallowed certain management fees on the basis that the service allegedly rendered were being duplicated as the appellants had competent and skilled personnel to discharge the same functions.

[38] In the *Nestle* case above, I said the respondent is entitled to scrutinize and question intragroup business models that may appear to be mere tax evasion schemes. It has the statutory mandate to collect taxes and protect the fiscus from errant tax planning schemes. On the other hand, businesses are entitled to adopt models or concepts that offer the best advantage in the reduction of the cost of doing business for optimum profitability. The position is settled that the central revenue collector cannot assume an armchair position and decide for businesses how to run their operations: see *IAB Co v ZRA* HH 32-22, at p 12 of the cyclostyled judgment.

[39] In the present case the court is satisfied that there was no duplication of services. There are always differences, admittedly marginal in some respects, between the functions of the appellants' local personnel and the services that they receive from its affiliates from abroad.

[*d*] *20% Penalty*

[40] The issue of the penalty that the respondent is entitled to levy in respect of any outstanding tax is generally problematic in view of the huge discretion reposed in it by legislation. The purpose of such penalty is to punish the individual wrongdoer and to deter other prospective wrongdoers: *ITC 1351* [1982] 44 SATC 58 and *PL Mines v ZRA* 2015 [1] ZLR 708 [H]. The respondent is entitled to charge additional tax of up to 100% of the outstanding tax.

[41] In the present case, the respondent argues that, among other things, with the impressive array of professional tax advisers at its disposal, Profeeds should not have fallen foul of the tax law in the respects it did.

[42] The approach of the courts to the question of additional tax or penalty is to consider whether there has been a deliberate evasion, a careless or inadvertent omission or a misstatement by the taxpayer: see *PL Mines*, *supra*. No particular form of *mens rea* is required. All that the court has to consider objectively is whether an amount which ought to have been included was omitted, or whether an incorrect statement was rendered: *CIR v Di Ciccio* 1985 [3] SA 989 [T], 993E – G and *CIR v McNeil* 1959 [1] SA 481, 487E – G.

[43] Each case has to be determined on the basis of its peculiar facts. In the present case, the court finds that although there was a deliberateness on the part of the appellants, it was not to evade tax. Instead, it was to avoid paying a tax that they genuinely considered not to be due and in a currency they genuinely considered not to be legal tender. At any rate, they have succeeded in respect of the management fee. The 20% penalty aforesaid has to be set aside in its entirety

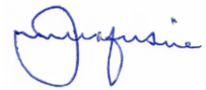
[*e*] *Disposition*

[44] The appeal is allowed in respect of the management fees and the shared services in respect of the service level agreements between Innscor and Profeeds, Progroup and Profeeds, and the 20% penalty. It is dismissed in respect of the respondent's

requirement for the appellants to pay tax in foreign on income generated in foreign currency.

[45] There having been no outright success by either party, and in line with the rules of practice in regards to public interest litigation, each party shall bear their own costs.

10 February 2025



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