DELTA CORPORATION LTD
versus
ZIMABWE REVENUE AUTHORITY

HIGH COURT OF ZIMBABWE
HLATSHWAYO J
HARARE, 23 January and 14 July, 2015

Fiscal appeal

Ms *D Ndawana*, for the appellant
Ms *V Nyamutowa,* for the respondent

HLATSHWAYO J: At the hearing of this matter I dismissed the appeal with costs and indicated that the reasons would follow. These are they.

The facts of this case are largely common cause. On 23 May 1996, a firm of accountants, Messrs Deloitte and Touche (hereinafter "Deloitte and Touche") wrote the following letter to the then Commissioner of Taxes (COT):

> "Dear Sir,
>
> BONUS SHARES (NINTH AND FIFTEENTH SCHEDULES TO THE INCOME TAX ACT)
>
> The above term is not defined in the statute.
> We would be grateful if you would advise us whether it is accepted that where a company, in declaring a dividend, allows its shareholders a choice of accepting cash or shares, those who opt for the latter receive "bonus shares".
>
> Yours faithfully
>
> D and T"

The COT responded on 8 July 1996 as follows:

> "Dear Sirs
>
> BONUS SHARES (NINTH AND FIFTEENTH SCHEDULES TO THE INCOME TAX ACT

[CHAPTER 181])

You letter dated 23rd May, 1996 reference RHMM/LWH/spw/12080 refers.
Please be advised that where a company declares a dividend which is immediately satisfied by issue of shares of an identical amount, no dividend is paid by the company and such shares constitute bonus shares.

Since there is no distribution of profits by the company and no property passed from the company to shareholders, what company does is to capitalise a portion of its profits. This does not constitute the payment of a dividend for income tax purposes. The fact that the company allows its shareholders an option of accepting cash or shares is not material.

Shares received in lieu of dividend are "bonus shares"

Yours faithfully

T.I NCUBE (MRS)
For: ACTING COMMISSIONER OF TAXES"

The appellant apparently acting on the strength of the above letter did not pay withholding tax on scrip dividends issued subsequent to that letter. On 24 November 2006, the Commissioner-General (COG) of the Zimbabwe Revenue Authority, who is the successor to the COT, wrote to the appellant requesting it to deduct and account for withholding tax for three years prior to that date on scrip dividends issued. The appellant wrote back on 5 December 2006 objecting and averred that in 1996 the COT had given a ruling upon the strength of which the appellant had acted. Such ruling, the appellant alleges, is binding on the current respondent. The respondent disallowed the objection on 30 January 2007 and maintained that the withholding tax was due and payable chiefly because a scrip dividend was a dividend and not bonus shares. The appellant was aggrieved by the decision and filed the present appeal.

The appellant's case is that the letter by the COT amounts to an advance tax ruling which binds the respondent and suggests that the benefits which are derived from the 1996 letter to Deloitte and Touche accrue to it as well. The appellant also avers that a scrip dividend is equivalent to bonus shares which type of shares are not subject to income tax in terms of the 9th and 15th Schedules to the Income Tax Act [*Chapter 23:06*]. It is also appellant's case that a scrip dividend is incorporeal property in lieu of cash. Appellant further contends that it would not be proper for the respondent to demand arrear taxes when it acted in line with an understanding with the COT.

The respondent's main line of defence is that the COT letter to Deloitte and Touche in 1996 did not amount to a tax ruling. Rather, respondent argues, it was just a confirmation of a position as perceived by Deloitte and Touche. The respondent also avers that if any benefit is to be derived from the said letter, such benefit can only accrue to Deloitte and Touche and not to the present appellant because it was not privy to the communication or transaction between Deloitte and Touche and the COT, the respondent's predecessor.

Regarding the standpoint taken by the appellant that the letter from the COT constitutes a tax ruling, one needs to understand the nature and import of an advance tax ruling which is defined in 4th Schedule to the Revenue Authority Act as "a written statement in the form of a binding general ruling, binding private ruling and binding class ruling issued by the Commissioner-General regarding the interpretation or application of the relevant Act". The procedural requirements for obtaining such a ruling are then spelt out as follows:

"*2. Application for advance tax ruling*
(1) Subject to the minimum requirements set forth in subparagraph (2), an application for an advance tax ruling must be made in such manner and in such form as the Commissioner-General may prescribe, and be accompaniedby the fee charged in terms of paragraph 18 of the Second Schedule, if any.
(2) An application must state the following minimum information—
(*a*) the applicant's name, postal address and telephone number; and
(*b*) the name, postal address and telephone number of the applicant's representative, if any; and
(*c*) a complete description of the proposed transaction in respect of which the ruling is sought; and
(*d*) a complete description of the impact the proposed transaction may have upon the tax liability of the applicant or, where relevant, any connected person in relation to the applicant, including any and all relevantinformation regarding the financial or tax implications of the proposed transaction; and
(*e*) a complete description of any transactions entered into by the applicant prior to submitting the applicationor that may be taken after the completion of the proposed transaction which may have a bearing on the tax consequences of the proposed transaction or may be considered to be part of a series of transactions involving the proposed transaction; and
(*f*) the proposed ruling being sought; and
(*g*) a citation of the relevant statutory provisions or issues; and
(*h*) the reasons why the applicant believes that the proposed ruling should be made; and
(*i*) a statement of the applicant's interpretation of the relevant statutory provisions or issues, as well as ananalysis of any relevant authorities either considered by the

applicant or of which the applicant is aware, whether those authorities support or are contrary to the proposed ruling being sought; and

(*j*) a statement to the best of the applicant's knowledge that the same or substantially the same or substantiallysimilar issue upon which a ruling is sought is not the subject of an audit, examination, investigation, ruling, application, objection and appeal, or other proceeding currently before the Commissioner- General or the courts involving the applicant or a connected person in relation to the applicant; and

(*k*) a draft version of the binding private ruling or binding class ruling to be issued; and

(*l*) a description of the information that the applicant believes should be deleted from the final ruling before the publication of the ruling in order to protect the applicant's confidentiality; and

(*m*) the applicant's consent to the publication of the ruling by the Commissioner-General.

(3) In addition to the minimum information required by subparagraph (2), an application for a binding classruling must also state the following minimum information—

(*a*) a description of the class members concerned; and

(*b*) the impact the proposed transaction may have upon the liability of the class members or, where relevant, any connected person in relation to the applicant or any class member.

(4) The Commissioner-General may request additional information from an applicant at any time."

The wording of the above section is peremptory and it is patently conjunctive. All those requirements must be present for any enquiry to be classified as an application for a tax ruling. Once the enquiry made is lacking in one or more material respects, it cannot be said to be an application for a tax ruling and in the absence of such application, any correspondence from the taxing authority cannot be construed as a tax ruling. One cannot obtain one without the other. The letter by Deloitte and Touche to the respondent's predecessor falls woefully short of the requirements detailed above. In fact, the enquiry remains just that and not an application for a tax ruling because it does not comply with para(s) (e), (f), (g), (h), (i), (j), (k), (l) and (m) above.

Even if the letter by Deloitte and Touche could have qualified as an advance tax ruling in the absence of the above noted statutory provisions, the issue now is whether the 'tax ruling' is binding on the current respondent. Section 5 (3) of the 4th Schedule to the Revenue Authority Act provides as follows:

> "(3) Any written statement issued by the Commissioner-General interpreting or applying the Income Tax Act [*Chapter 23:06*] prior to the 1st January, 2007, or any other relevant Act prior to the 1st January, 2009, is to be treated as and have the effect of a nonbinding private opinion, unless the Commissioner-General prescribes otherwise in writing".

The alleged tax ruling was made in 1996 and it related to the interpretation of schedules 9 and 15 to the Income Tax Act. The letter written by the COT, therefore, is by operation of law a non-binding private opinion, as the COG of the respondent has not directed otherwise. A non-binding private opinion is defined in the following words in s 1 of the 4th Schedule to the Revenue Authority Act:

> **"nonbinding private opinion"** means a written statement issued by the Commissioner General in response to an enquiry by a person in order to provide the person with informal guidance in respect of the tax treatment of a particular set of facts and circumstances or transaction, but which does not have a binding effect".

Further, the Revenue Act 4th Schedule makes it clear in s 5(2) that a nonbinding private opinion may not be cited in any proceedings before the COG or the courts "other than a proceeding involving the person to whom a nonbinding private opinion was issued". The Deloitte and Touche inquiry was not made in a representative capacity, and hence only the accounting firm may rely on it and not the appellant. Where a ruling is intended to benefit a certain class of persons, in terms of s 2 (3) of the 4th Schedule to the Revenue Authority Act, a description of the class members concerned must be made by the applicant. None was made in this case.

The appellant's attention was fully drawn to the above self-evident statutory provisions, and its insistence on its position on the point can only be regarded as having been frivolous, which frivolity, extending as it does to the rest of the appellant's submissions, inevitably has to be visited by an appropriate order of costs.

The respondent has taken the position that a scrip dividend is not the same as bonus shares and for that reason is not exempt from tax in terms of the 9th and 15th Schedules to the Income Tax Act. In terms of ss 26 and 28 of the Income Tax Act, shareholders are liable to pay tax on their dividends. The company distributing such dividends is at law required to withhold such tax when it distributes the dividends and remit the same to the respondent. *See sections 2 (1) of both the 9th and 15th Schedules to the Income tax Act*. Dividends for the purposes of shareholders' taxes are defined in terms of the 9th and 15th Schedules to the Income Tax Act as follows:

'dividend' means any amount which is distributed by a company to its shareholders….

The most important principle in relation to this emanates from the reading of the section itself. The wording of the letter from Messrs Deloitte and Touche to the Commissioner of taxes becomes relevant. It speaks to the state of the transaction involved. It says in part *'….where a* *company, in declaring a dividend, allows…'* The very act of declaring a dividend is distribution of an amount to the shareholders. At this stage, before any further considerations are made, the amount so declared is a dividend and subject to the withholding tax. The fact that the shareholders are then allowed an election after the declaration of the dividend matters not. By then, taxes would already have accrued by operation of law. The act of declaring a dividend is not linked to the choice the shareholders are given in whether to accept cash or take a scrip dividend. The former precedes the latter. At the point the former is declared, tax is chargeable. Therefore, as at the time a dividend is declared, the appellant is obliged to withhold tax for onward transmission to the respondent. What happens to the dividend after that stage matters not for purposes of taxation. This position is buttressed by section 1 (2) under both the 9^{th} and 15^{th} Schedules to the Income Tax Act. The sections are similar and they provide for the following:

> *"A dividend shall be deemed to be distributed when it is paid to the shareholder, credited to his account or so dealt with that he becomes entitled to it, whichever occurs first".*

The question whether the appellant capitalised its profits can only be determined by having due regard to the circumstances surrounding the transaction. This position was succinctly put forward by Benjamin J in *Wilson* v *Commissioner for Inland Revenue* 1926 CPD 63 70 in the following words:

> "From a consideration of the judgment in that case it appears the test to be applied is what was the intention of the company dealing with the matter, did the company intend that the sum dealt with should become income or capital. Thus Innes, C.J., in discussing the case of *Bouch* v, *Sproule* (12 AC 385) said (at p.357): -
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> > 'It was a dispute as to whether the tenant for life or the remainder man was entitled to a bonus dividend applied in part payment of certain bonus shares. That depended upon whether the bonus was income passing to the tenant for life under the will or was an accretion of capital enuring to the ultimate benefit of the remainder man. So that the point which lies at the root of the present appeal fell to be decided: The facts were that the directors distributed certain accumulated profits (which had been temporarily capitalized) as a bonus dividend and allocated the new shares (partly paid up) to each shareholder, applying the bonus dividend in part payment of the new shares. under these circumstances it was held.... that the company did not pay or intend to pay any sum as dividend, but intended to do, and did, appreciate the undivided profits as an increase of the capital stock; the bonus dividend was therefore capital of the estate and the life tenant was not entitled to it or the shares.'

> Again, in discussing the case of the Commissioner for Inland *Revenue* v. *Blott* (35 T.L.R 687, 36 T.L.R. 575, 125 L.T 4970 he said (at p. 358): "The principle of *Bouch* v *Sproule* was applied- namely that where the company has the power of capitalizing or distributing profits and decided to capitalize them, then the nature issued in respect of such profits was determined by the company's intention; and it was held that the procedure followed did not alter the real nature of the transaction."
>
> Again, a little lower down in the judgment he said (at p. 361): "The company ought in the words of Lord HALDANE to be 'dominant on the question whether the money in question was to be income or capital for all purposes.'"

It immediately becomes clear that for the shares to be considered bonus shares, it must have been a capitalisation of the undistributed profits at the instance of the company. Once a dividend is paid out and the shareholder is given the option to use such cash dividend to buy more shares, such shares so bought are not bonus shares. This is no more than the shareholder electing to use his dividend to purchase more equity in a company.

The letter by Deloitte and Touche is clear in its tenor. The choice is given to the shareholder whether to take the dividend in cash or in shares. There is nothing which stops the company from distributing the dividends in cash. In the same vein, there is nothing which would stop a shareholder from accepting some of the dividend in cash and the other part in shares. The intention of the company is paramount here; it was to distribute dividends to its members. It then gave the members a choice of accepting either cash or shares. The scrip dividend in this case does not cease to be a dividend. It is a dividend dealt in a particular way by the shareholder and not the company and it does not lose its status as a dividend. The scrip dividend in these circumstances is a dividend and not 'bonus shares.'

The submission by the Appellant that the *'the company's accumulated profits have, as a matter of accounting practice, therefore been capitalised and thus the shareholder has received nothing out of the assets of the company for his separate use and benefit'* cannot be correct. The election to receive shares in lieu of a cash dividend in itself is a purchase of shares. The choice given to the shareholder is that which shows that the profits have been distributed and the shareholder has elected to use his dues to buy more equity. Since a shareholder who accepts the divided in cash is liable to pay tax, the fact that another has elected to deal with their dividend in a different manner does not make the dividend so received and utilised any less a dividend. The election to receive shares is a purchase of shares and the shareholder would have received something out of the assets of the company for his separate use and benefit. By distributing the dividend in the first place, the amount representing that dividend would have ceased to be part of the company's assets. The mere declaration of a dividend payable in one manner or the other means that such dividend ceases to be part of the company's assets and can be used by the shareholder in any manner he or she pleases. On this premise, the contents of the letter by the COT to Deloitte and Touche do not capture the correct position of the law.

Equally untenable is the argument that a scrip dividend is not a dividend in that it is not an 'amount distributed by a company to its shareholder.' The fact of the matter is that the election only arises after the dividend is declared, the default position is that the dividend will be paid out in cash, an amount. When the shareholder elects to have shares instead, the shareholder would have disposed of his cash dividend and bought shares with it. The cash dividend which finances the purchase of shares in an 'amount.' The scrip dividend in that regard is also an amount.

It is not in doubt that after the appellant declared dividends, it invited its shareholders to decide whether to accept cash for the dividends or accept shares in lieu of cash. The acceptance of shares *in lieu* of cash simply means that the shareholders would have used their dividends to buy more shares in the appellant. The acceptance of shares in lieu of cash is no more than an instruction by the shareholder that his dividend ought to be used to purchase shares. This is totally independent from the declaration of the dividend. The declaration of the dividend is the act of the company and the acceptance of a scrip dividend is the act of a shareholder after the dividend has been declared. Now, 'bonus shares' are shares which are given out by the company to its shareholders on a pro-rated basis and they are paid for from the company's undistributed reserve profits.

The intentions of the appellant are clear from the letter. There was no scheme of the capitalisation of capital going on. The shareholders were given an election which they duly exercised. This is distinctly different from capitalisation of undistributed profits. The moment a company declares a dividend, and issues it out, the profits are distributed in the form of cash. The question of bonus shares does not arise as the company by declaring a cash dividend would have distributed the profits to its member. The question of bonus shares, which come about where a company does not distribute profits in cash and gives the members more shares in line with their shareholding in the company, does not arise in this case because the profits were distributed to the shareholder in cash as dividends. 'Bonus shares' are fully paid up using the company's reserve undistributed profits.

The declaration of a dividend is in its own a distribution of profit. As such, the question of bonus shares cannot arise where such shares are paid for by proceeds from a dividend. In other words, a scrip dividend is not the same as a bonus share. The Commissioner of Taxes was clearly wrong in saying that in a script dividend situation, there is no distribution of profits and no property is passed from the company to the shareholders. In a scrip dividend scenario, it is the individual shareholder who invests his dividend by purchasing more shares. In a bonus share arrangement, it is the company which pays for shares from the undistributed reserve profits and distribute the same to the members on a pro-rated basis. Both of these schemes result in shares for the members of a company but a scrip dividend is shareholder driven and a 'bonus share' scheme is company driven. As such, the principle relating to the two ought not to be conflated. Perhaps the most important point to note is that where a dividend is declared, the shareholder becomes entitled to it and it attracts tax as at that point and the choice to take a scrip dividend can only be made after such tax is due by operation of law.

Now, regarding the retrospective effect of the COG's measures, the revenue authority is not entitled at law to give anyone unlawful tax breaks and prejudice the *fiscus.* Where the revenue authority has made an error, it is allowed to rectify it, even retrospectively. The appellant relies on *Commissioner of Taxes* v *Astra Holdings (Pvt) Ltd* 2003 (1) ZLR 417 (S) for the proposition that the taxing authority is required at law to act fairly towards both the taxpayer and the *fiscus.* In this light, the allegation is that the appellant has acted on the strength of the COT's ruling and requiring it to pay withholding tax going three years back would be unfair. However, as a matter of law the respondent is not precluded from assessing a tax legally due only because the taxpayer has relied upon the respondent's predecessor's prior mistaken view of the law. In *Dixon* v *United States* 381 U.S. 68 (1965), it was said in part:

> "Commissioner is empowered retroactively to correct the mistakes of law in the application of the tax laws to particular transactions. He may do so even where a taxpayer may have relied to his detriment on the Commissioner's mistake…. This principle is no more than a reflection of the fact that Congress, not the Commissioner, prescribes tax law".

The argument by the appellant that the decision to have it pay withholding tax for the three prior years is unlawful is untenable. The point here is that the appellant cannot require the respondent to continue acting unlawfully in order that its actions be fair. The main duty on the respondent is to act lawfully and in demanding the withholding tax, it acted lawfully. There is no question of the respondent acting unfairly when it acts in accordance with the law, in other words lawfully. Implicit in lawfulness is fairness.

A similar principle can be derived from *Tregers Industries (Private) Limited* v C*ommissioner General of the Zimbabwe Revenue Authority* 2006 (2) ZLR 62 (H) wherein Garwe JP (as he then was) said:

> "The applicant argued that the respondent is "estopped" by the actions of his subordinates from denying that the applicant's interpretation of section of the Act is correct. I do not accept this submission. What the applicant is saying is that irrespective of the correct interpretation, the fact that the respondent's employees accepted that the goods in question were zero rated estops the respondent from arguing to the contrary. As a matter of law that cannot be correct. If an interpretation of the law is not correct, then that interpretation is not correct. The fact that respondent's employees may not have looked into the matter more carefully cannot estop the respondent from arguing that such interpretation is not correct".

The respondent cannot be estopped from acting lawfully. What is apparent is that the appellant cannot seek to enforce an unlawful position on the basis that it would be unfair on it should the respondent revert to acting lawfully. Sight should not be lost of the fact that tax law is strict liability law. The fact that the respondent's predecessor made a mistake upon which it relied does not save the appellant. It would be still required to remit all taxes as is required at law.

It is for these reasons that I dismissed the appeal with costs.

Gill, Godlonton and Gerrans, appellant's legal practitioners
Sinyoro and Partners, respondent's legal practitioners