Beneficial Ownership under Tax Law in Botswana: A Foregone Opportunity with *the Cresta Marakanelo Case*

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ABSTRACT

Beneficial ownership is pivotal to any discussion of tax avoidance, especially international tax avoidance which forms the backbone to the phenomenon of base erosion and profit. It is a concept under which an attempt is made to find the "true" or "real owner" of tax benefits especially where another person or entity claims such benefits under aggressively designed tax avoidance schemes. Its importance notwithstanding, the concept of beneficial ownership has been notoriously difficult to define. This paper argues that the 2010 Cresta Marakanelo case was an ideal opportunity for the High Court in Botswana to elucidate on the meaning and application of the concept, but, surprisingly, this was not done. A brief review and discussion of the case is preceded by a discussion of notable cases from other jurisdictions, which highlight the importance and difficulty of defining beneficial ownership, and by an overview of the incorporation of the concept in some international tax treaties.

1 INTRODUCTION

The concept of beneficial ownership has been discussed in the world of international taxation from as early as 1906. But there is still no universal, all-encompassing, acceptable definition of the concept. The paper first refers to some notable international tax cases which attempted to deal with the concept. It secondly refers to treatment of the concept in several tax treaties. It then conducts a review of the *Cresta Marakanelo case*,[1] to demonstrate that the case represents a forgone opportunity to clarify the meaning and application of the concept under Botswana's tax jurisprudence.

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1. *Cresta Marakanelo (Pty) Ltd v Attorney General* [2010] 1 BLR 273 (HC)

2. OVERVIEW OF BENEFICIAL OWNERSHIP IN COMPARATIVE JURISPRUDENCE

The 1906 case of *Montana Catholic Mission v Misoula County*[2] is historically one of the earliest cases to attempt a definition of beneficial ownership worthy of consideration even in modern discourses. The court observed:

> "The expression "beneficial use" or "**beneficial ownership** or interest" in property is quite frequent in the law, and means, in this connection, such a right to its enjoyment as exists **where the legal title is in one person and the right to such beneficial use or interest is in another**, and where such right is recognized by law, and can be enforced by the courts, at the suit of such owner or of someone in his behalf."[3]
> (My emphasis)

Two things emanate from the above definition. The first aspect, now trite, is that beneficial ownership is a concept rooted in the common law concept of a trust.[4] The second related aspect is that the law of equity, applicable to trusts, also applied to interpretation of beneficial ownership.[5] In consonance with equitable principles, therefore, beneficial ownership entailed that legal title could be reposed in one person, and the right to such beneficial use or interest in another.[6] The common law of Botswana and several other countries in Southern Africa is said to be Roman Dutch law, under which English common law principles of equity do not apply. The concept of beneficial ownership, however, can be readily accommodated under Roman Dutch common law as a species of limited or qualified ownership. The right of ownership in Roman

2 200 U.S. 118 (26 S.Ct. 197, 50 L.Ed. 398) accessed 17 May 2015 at https://www.law.cornell.edu/supremecourt/text/200/118

3 C. du Toit , "The Evolution of the term "Beneficial Ownership" in relation to International Taxation over the past 45 years" *Bulletin for International Taxation* (October 2010) 500 at p. 502

4 P Arginelli, P. S. Mariano da Silva , C. Ellul , and A. Storckmeijer, "The *Royal Bank of Scotland Case*: More Controversy on the Interpretation of the term "Beneficial Owner"*"* in R. Russo (ed), and R. Fontana, *A Decade of Case Law: Essays in honour of 10th Anniversary of the Leiden Adv LLM in International Tax Law* (Amsterdam: IBFD, 2008)

5 N Ntshele 'The Interpretation of the term "Beneficial Ownership" in South Africa for International Tax Purposes' (unpublished Masters in Commerce dissertation) University of Johannesburg, October 2013 at p.20

6 L. Olivier, and M. Honiball*, International Tax: A South African Perspective* 3rd Edition (Cape Town Siber Ink 2005) at p.233; C. Vargas, "Beneficial Ownership lacks proper meaning" 15(5) *International Tax Review* (2004)

Dutch common law is not conceived or understood as an absolute.[7] It can be qualified or restricted.

The *Aiken Industries case*[8] is the other notable decision on this topic. Although it did not expressly discuss beneficial ownership expressly, it is notable because it canvassed a similar notion of "received by" found in the US-Honduras treaty. The court was tasked with determining whether Mechanical Products Inc. could rely on benefits provided for under the treaty in respect of interest payments on a loan it had received, which would have otherwise been subject to 30% withholding tax. The promissory notes issued by Mechanical Products Inc. to Ecuadorian Corp. Ltd (Bahamas) had been transferred to Industrias Hondurenas in Honduras and the tax payer sought to invoke the US-Honduras treaty as there was no treaty between US-Bahamas.

The court held that Mechanical Products Inc. (incorporated by Aiken) should have levied the 30% withholding tax as the interest was received by Ecuadorian Corp. Ltd in the Bahamas. The court was of the view that the term "received by" did not mean merely gaining possession on a temporary basis and immediately transferring the funds, but contemplated complete dominion and control of the funds. In essence, the court found that the Honduran company was not the beneficial owner of the funds. This explanation differs slightly with the *Montana case* as it refers to complete dominion and control of the funds bringing beneficial ownership closer to legal ownership.

The 1994 *Royal Dutch Petroleum case*[9] is the next noteworthy case. In this case, a UK resident corporate stockbroker purchased dividend coupons of Royal Dutch Shell from a company resident in Luxembourg. The Luxembourg Company remained the underlying owner of the shares. When paying the dividends, Royal Dutch Shell levied a withholding tax of 25% which was in terms of Dutch domestic law. The UK-Netherlands tax treaty did not allow a withholding tax in excess of 15% and working from the premise that he was the beneficial owner in terms of the treaty, the stockbroker claimed a refund, (being the 10% excess) that he had been charged. The Dutch inspector held that

7 D. P. Visser, "The Absoluteness of Ownership: The South African Common Law in Perspective" *Acta Juridica* (1985) pp.39-51.

8 *Aiken Industries v Commissioner of Internal Revenue*, 56 T.C 925; L. Freitas de Moraes e Castro, "US Policy to Counter Treaty Shopping - From Aiken Industries to the Anti-Conduit Regulations: A Critical View of the Current Double-Step Approach from the Perspective of Treaty Objectives and Purposes" 2012 *Bulletin for International Taxation* p.300

9 Decided 6 April 1994 by the Netherlands Supreme Court

the stockbroker was not entitled to this benefit as he had not been the owner of the underlying shares. The Supreme Court reversed this decision, holding that he was indeed the beneficial owner and that no requirement existed for the beneficial owner to be the owner of the underlying shares.[10]

The decision is particularly notable because the Supreme Court severed the umbilical cord that the *Aiken Industries case* had created by bringing beneficial ownership and legal ownership close together. Du Toit insightfully pointed out that the decision focused solely on beneficial ownership as an independent concept away from the travesties of treaty shopping and any other underlying causes that may have informed the structure adopted.[11]

The next notable contribution to the discourse was in the *Indofood case.*[12] The facts were that in 2002 Indofood issued bonds (loan notes) on the international market to try and raise funds. If it had opted to do so directly it would have been susceptible to 20% withholding tax on interest it paid on the said bonds. In the light of this, it established a Mauritian subsidiary which then issued the bonds, with J. P. Morgan Chase Bank acting as a trustee for the bondholders. Interest paid from Indonesia to Mauritius benefitted from the Mauritius-Indonesia treaty with a reduced withholding tax of 10%. The Mauritian subsidiary would borrow an amount identical to that which it lent the Indonesian parent. The rate of interest to and from Mauritius was also identical. In fact, it was found that the interest was paid directly from the Indonesian parent to the bondholders missing out the Mauritian subsidiary entirely.[13]

In June 2004, the Indonesian government announced its intention to terminate the Indonesia-Mauritius treaty in January 2005. Consequently, the reduced withholding tax rate of 10% would be increased to 20%. Indofood then notified J. P. Morgan Chase Bank of its intention to pay off the bonds immediately to avoid the higher withholding tax.

The bank proposed an alternative structure under which a Dutch subsidiary would receive the interest just as the Mauritian subsidiary had done. This would have supposedly enabled them to benefit from the Indonesia-Netherlands treaty, which also had a reduced withholding tax rate of 10%.

10 Arginelli, Mariano da Silva, Ellul, and Storckmeijer, *loc cit.*
11 Du Toit, *op. cit.* at p. 504
12 *Indofood International Finance Ltd v JP Morgan Chase Bank NA London Branch* [2006] EWCA Civ 158
13 P. Baker, "Beneficial Ownership: After Indofood" VI(I) *GITC Review* (2007) 15 at p.19

Indofood rejected this proposal on the basis that the new Dutch entity would not be held to be a beneficial owner in terms of the Indonesia-Netherlands Treaty.

The court in the *Indofood case* took an economic substance over form approach, away from the strictly legal or formal approach that had previously been followed in interpreting beneficial ownership.[14] The court referred to the "international fiscal meaning" away from domestic states interpretation. It looked at the legal, commercial and practical structure and expressly stated that the meaning should not be limited to a legal or technical meaning but should encompass factual and economic considerations. As a decision of a UK court, the Indofood case is likely to be regarded as more persuasive in Botswana.

The next notable decision is in *Prevost Case*,[15] a decision of a Canadian tax court. The court had to determine whether a Dutch subsidiary (PHB.V.) of a Canadian resident company (Prevost) with shareholders in Sweden (Volvo) and UK (Henlys) was the beneficial owner of the dividends it received from its parent, which it then disbursed to the respective shareholders. The issue centred on the withholding tax implications arising if the Dutch subsidiary was the beneficial owner, and the Canada-Netherlands tax treaty applied. Under Canadian domestic law, withholding tax was 25% but the treaty provided for a maximum rate of 5%.The court, in holding that the Dutch subsidiary was indeed the beneficial owner, seems to have gone back to the common law interpretation which treads very closely to the concept of legal ownership. The court even described the beneficial owner as the "real or true owner" who ultimately exercises the right of ownership.[16]

In the assessment of the court, the test for beneficial ownership ought to be: "the person who receives the dividends for his or her own use and enjoyment and assumes the risk and control of the dividend he or she received. The person who is beneficial owner of the dividend is the person who enjoys and assumes all the attributes of ownership."[17] The court took a deliberate step to reject the idea of economic substance in *Indofood.* It would appear that at this point the definition of beneficial ownership had reverted back to become intangible and

14 A. Wardzynski, "The 2014 Update to the OECD Commentary: A Targeted Hybrid Approach to Beneficial Ownership" 43(2) *INTERTAX* (2015) 179 at p. 185

15 *Prevost v Her Majesty The Queen* 2004-2006(IT)G and 2004-4226(IT)G

16 N. Boidman & M. Kandev, "News Analysis: Canadian Taxpayer Wins Prevost Appeal" 53(10) *Tax Notes International* (2009) 861.

17 A. Wardzynski, "The 2014 Update to the OECD Commentary: A Targeted Hybrid Approach to Beneficial Ownership", 43(2) INTERTAX (2015) 179 at p. 180.

closely linked to ownership. It should however be noted and appreciated that a decision of a Canadian tax court the *Prevost* case might not be regarded as persuasive as the *Indofood* case in Botswana.

3 OVERVIEW OF BENEFICIAL OWNERSHIP IN TREATY LAW

The concept of beneficial ownership was first incorporated in a 1945 United States-United Kingdom Treaty on the Estates of Deceased Persons. Article III of this Treaty, (which was not about tax issues), referred to "shares or stocks held by a nominee where the beneficial owner was evidenced by script certificates or otherwise."[18] Thereafter, its next treaty appearance was is in the 1966 US-UK Protocol, which gave the world of international tax its first insight into the concept.[19] An explanatory note attached to the protocol provided that "relief from tax on dividends, interest and royalties... in the country of origin will no longer depend on whether the recipient is subject to tax in the other country, but will depend on the income being beneficially owned by a resident of the other country…"[20]

The definition of beneficial ownership in this note was similar to that in the *Monatana Case*, which was generally understood and applied in countries following the English common law tradition. Subsequently, treaties involving some of these countries, such as UK- Netherlands (1967) and UK-Australia (1967),[21] incorporated the concept, but it remained unknown to the Organisation for Economic Co-operation and Development (OECD). It is perhaps this deficit that urged the UK to make its comment to the OECD in 1967 in relation to Article 10 on Dividends, a comment that has arguably led to the inclusion of beneficial ownership in the subsequent Model Tax Convention.[22]

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18 D. Oliver, et al. "Beneficial Ownership", 54(7) *Bulletin for International Fiscal Documentation (*2000) 300 at p.310.

19 J. Bernstein, "Beneficial Owneship: An International Perspective" *Tax Notes International* (2007) p.1211; H. M. Nantumbwe, *Beneficial Ownership in International Taxation: Comparative Study of its Application in the United Kingdom and Canada*, (unpublished Masters of Law dissertation) Queen Mary University of London, August 2012.

20 Du Toit, *loc. cit.*; see also D. P. Sengupta, "Beneficial Ownership - The Holy Grain of International Taxation?", (2012) accessed 17 May 2015 at http://www.taxindiainternational.com/printContent.php?qwer43fcxzt=ODU=&flag=2

21 Ntshele, *op. cit.* at p.19.

22 OECD Model Tax Convention accessed 10 March 2018 at http://www.oecd.org/ctp/treaties/2017-update-model-tax-convention.pdf

In its estimation, the UK believed that "the relief provided for under these Articles ought to apply only if the beneficial owner of the income in question is resident in the other contracting State, for otherwise the Articles are open to abuse by taxpayers who are resident in third countries and who could, for instance, put their income into the hands of bare nominees who are resident in the other contracting State …"[23]

This statement not only gives a possible explanation for the subsequent inclusion of beneficial ownership in the OECD, but also gives the purpose or economic impetus for its adoption. The purpose is to restrict access to treaty benefits by mere recipients of the income who are not "beneficial owners."[24] Simply, the aim of beneficial ownership is to prevent treaty shopping.[25]

The concept of beneficial ownership ultimately found its way into the OECD Model Tax Convention in 1977. Unfortunately, as can be extracted from the cases discussed above, the concept entered the world that blends common law and civil law states, with no precise definition. Moreover, the 1977 OECD commentaries also provided little to no guidance on its interpretation, seeking only to exclude agents and nominees.[26] This inevitably opened a Pandora's Box. Was it to be understood as had been in the common law world where it was conceived? Was every state adopting model to attach its own meaning based on its domestic law? However, this would be impractical in civil law states where the concept remained unknown.

The 1986 OECD Conduit Companies Report[27] sought to bring clarity on the matter, almost 10 years late. It attempted to do so by expanding the list of entities that would not be included as beneficial owners, but it did not attempt a definition of beneficial ownership. Du Toit[28] submits that if one is to

23 OECD Fiscal Committee, "Observations of Member Countries on difficulties raised by the OECD Draft Convention on Income and Capital", TFD/FC/216, p. 14.

24 V. Krishna, "Treaty Shopping and the Concept of Beneficial Ownership in Double Tax Treaties" 19(11) *Canadian Current Tax* 2009 129 at p.130; H. M. Nantumbwe, *Beneficial Ownership in International Taxation: Comparative Study of its Application in the United Kingdom and Canada*, (unpublished Masters of Law dissertation) Queen Mary, University of London August 2012 at p. 11.

25 Arginelli, Mariano da Silva, Ellul, and Storckmeijer, *loc cit.*

26 R. Danon, "Clarification of the meaning of "Beneficial Ownership" in the OECD Tax Convention-Comment on the April 2011 Discussion Draft" *Bulletin for International Taxation* (August 2011) 437; J Li "Beneficial Ownership in Tax Treaties: Judicial Interpretation and the Case for Clarity" *Comparative Research in Law & Political Economy. Research Paper No. 4/2012* (2012) 187 at p. 189.

27 D. G. Duff, "Responses to treaty shopping: a comparative evaluation." *Tax treaties: building bridges between law and economics. Amsterdam, IBFD* (2010) discusses examples of scenarios applying by the Commentary.

28 Du Toit , *op. cit.* at p. 503

try and extract a definition of beneficial owner from the 1986 OECD Conduit Companies Report, one is led to believe that they imagined a person who had very narrow powers and does not hold the biggest weight of ownership attributes.

The next development is the 2003 amendment to the OECD Commentaries, which moved away from the 1977 narrow position to a substance-over-form approach that arguably mirrors the *Indofood case*, stating that "that the term beneficial ownership is not used in a narrow and technical sense, rather it should be understood in its context in light of the objects and purpose of the Convention including avoiding double taxation and the prevention of fiscal evasion and tax avoidance."[29]

4 THE *CRESTA MARAKANELO CASE*

The case came before the High Court by way of review from a determination made by the Commissioner General. On 7 October 1987, the applicant, Cresta Marakanelo (Pty) Ltd, (then Marakanelo (Pty) Ltd), entered into an agreement with Metonic Investments, (a non-resident company), or its nominee, for the provision of management and operational services. The contract, (the 1987 Agreement), commenced on 1 October 1987 and was to run for an initial period of ten (10) years. The contract ran for the stipulated initial period and was renewed indefinitely, subject to termination by either party through six (6) months' written notice. The agreement also provided for prior approval by Marakanelo (Pty) Ltd of any purported assignment of its rights and obligations by Metonic Investments, and for due notice, in writing, to be given of the assignment being offered and received by the assignee.

Since payments to Metonic Investments were being made to a non-resident company, withholding tax of 15% was charged accordingly. The withholding tax was charged from the commencement of the contract in 1987 to 1994 when, in a bid to minimize its tax liability, Metonic Investments assigned its rights to receive the management and operational payments to two resident companies, TA Botswana (Pty) Ltd (TAB) and Trans Industries (Pty) Ltd (TI).

29 M. Rossi, "Beneficial Ownership, Tax Treaties and International Tax Planning in light of the UK Court of Appeal decision of March 2, 2006 in *Indofood International Finance Ltd" International Fiscal Association* (2007) at p.8

The assignment was made to TAB from January 1994 to December 1998, and subsequently to TI from January 1999 to December 2002. As a consequence, the applicant would not be subject to withholding tax on the management and operational services paid to resident companies.

The Commissioner General deemed the assignments by Metonic Investments to be artificial or fictitious submitting that the real recipient of the management fees was not the two resident companies (TAB and TI) but Metonic Investments' holding company, Eagle Trustees, also a non-resident company. Effectively, the Commissioner was of the view that the beneficial owner of the payments for the management and operational services was Eagle Trustees, warranting a withholding tax liability. The Commissioner General further contended that no written notice was given in terms of Articles 24 and 25 of the 1987 Agreement and, therefore, the purported assignment to TAB and TI was a "concocted afterthought consciously created to avoid paying withholding tax."

The Commissioner General relied on the applicant's general ledger, financial statements and suggestions it received from PriceWaterhouse on how to reduce its withholding tax liability. The applicant challenged the Commissioner General's findings as largely based on misconceptions and misunderstandings.

The court referred to the decision of the South African Court of Appeal in *Commissioner of Inland Revenue v Conhage* [30] where tax-minimising strategies were endorsed only if they give the true nature and substance of the transaction, and not a deception through its form. This proposition was partially applied to the case before the Botswana High Court. On the basis of the evidence before it, the court found as a fact that for the first two years of the 1987 Agreement, Eagle Trustee, a non-resident entity, was a "true recipient" of the fees payable under the agreement to Metonic Investments. Withholding tax was therefore payable. Thereafter, Eagle Trustees ceased to be "true recipient", but the two resident companies were. Withholding tax was therefore not payable. In other words, the transfer of Metonic's right to receive payments for services rendered to two resident companies was neither a sham nor a colourable transaction. It was a legitimate tax minimising strategy, which had to be given effect. The Court came to this conclusion without any reference to the concept of beneficial

30 1994 4 SA 1149 cited at p. 282 of the *Cresta Marakanelo* judgement

official ownership and elucidation of the meaning of "true recipient", the phrase it preferred to employ.

5 CONCLUSION

Despite the fact that the matter came before the court as a review and not an appeal where the court could have canvassed the merits of the case, it is submitted that this is an opportunity foregone by the court to engage with and bring clarity to beneficial ownership in our jurisdiction. The court failed to rise to the occasion, to clarify what the law in Botswana should be as regards the concept of beneficial ownership. Should the concept be defined in a technical and legal manner, or should it embrace economic considerations of substance over form, as suggested in *Indofood*. It is submitted that the reference to *Commissioner of Inland Revenue v Conhage*, which suggests a need to look at the true nature and substance of the transaction, should have been the springboard to fuller consideration of the elements of the concept of beneficial ownership traversed in this review.