IN THE COURT OF APPEAL OF THE REPUBLIC OF BOTSWANA
HELD AT LOBATSE

COURT OF APPEAL CIVIL APPEAL NO. CACLB-096-10
HIGH COURT CIVIL CASE NO. CAHLB-000057-09

In the matter between:

ECONET WIRELESS GLOBAL LIMITED **APPELLANT**

and

THE COMMISSIONER GENERAL OF TAXES **RESPONDENT**

Adv. J. Peter SC (with Ms B. Machinya) for the Appellant
Mr Attorney J.B. Akoonyatse for the Respondent

J U D G M E N T

CORAM: **KIRBY J.P.**
MOORE J.A.
LEGWAILA J.A.

KIRBY J.P.

1. This is an appeal brought in terms of section 93 (2) of the Income Tax Act Cap 52:01 (the ITA) against a judgment of Makhwade J. handed down on 26th November 2010. This determined a section 91 appeal made to the High Court against the respondent's decision to disallow in full objections raised by the appellant to income tax assessments for the tax years 2005 and 2006. The objections were to sums of P23,674,247 for 2005, and P26,809,363 for 2006, deemed as interest income in terms of section 134 of the ITA. That is all.

2. Instead of merely allowing or disallowing the appeal, the court made the following orders:

> "(a) The appeal on the decision by the respondent to conclude that the appellant was a close company, is dismissed.
>
> (b) The issue as to whether or not the appellant is an international financial services certificate company is not properly before court and therefore the court declines to pronounce on it.
>
> (c) The appeal on the ground that section 134 is not applicable to loan debtors is upheld.
>
> (d) The respondent is entitled to apply the provisions of section 133 of the Income Tax Act to the amount paid out by the appellant.
>
> (e) Each party shall pay its own costs."

3. The appeal is against Orders (a), (b), (d) and (e) on the ground that each of these was misdirected:

- on Order (a) the complaint is that the appellant should, in terms of section 130 of the ITA have been found to be a public company rather than a private one for the purposes of that Act, and thus was not a close company.
- as to Order (b) the appellant avers that the IFSC issue was raised by the respondent and not by it, and was properly before the court.
- as to Order (d), it is argued that the Judge a quo erred in holding that by virtue of section 92 (1) of the ITA he could authorize the imposition of tax on deemed dividends under section 133, when this was fundamentally different to the basis upon which the appealed assessments were made, and would require new assessments.
- the appellant also feels that costs should properly have been awarded to it.

4. The fact that the appeal was allowed to encroach into areas not contemplated either in the assessment or in the objection thereto, is unfortunate. I shall say more about this later. The order made by the Judge a quo also led to a dramatic and no doubt unexpected post-appeal sequel, when the respondent, relying on Order (d) above, issued a letter of demand, requiring the appellant to pay not the original assessed sum of P4,661,614-25 but a revised sum of P58,999,581-05, more than twelve times as much.

This is how it happened.

BACKGROUND

5. The appellant is a financial services company, focusing on the telecommunications industry, and serving mainly non-resident clients, many being related companies. On 5th November 2003 the appellant (which had formerly been a private company) was recognized and registered by the Registrar of companies as a public company. During the period relevant to this appeal it had two shareholders, Econet Wireless Group Ltd (British Virgin Islands) and Allied Technologies Ltd (South Africa), which each held 1500 shares.

6. On 31st March 2006 the appellant submitted its income tax return for the 2005 tax year. It returned a loss of P5,027,790. On 28th April 2006 the appellant's return for the 2006 tax year was submitted, and this time a loss of P46,682,083 was returned (the somewhat unusual dates are explained by the fact that the appellant's financial year closed on 28th February). On both returns the response to the question "Does the company claim to be recognized as a Public Company in terms of the Income Tax Act?" was "No".

7. The interest of the respondent was aroused and a tax audit of the appellant's affairs was set in motion. More than two years later, on 16th May 2008 revised assessments were issued for 2005 and 2006. The Form ITA 22 assessments record that for 2005 deemed interest of P23,674,247 was added on the income side, resulting in a profit of P18,646,457, and tax payable of P4,661,614-25. For 2006, deemed interest of P26,809,363 was added, reducing the returned loss to P14,844,930. No tax was payable. In neither case was the section stated under which the charge was being made. It is not in dispute, however, that the charges were raised in respect of interest free loans made by the appellant to related companies during the tax years in question, and that sections 132 and 134 of the ITA were relied upon.

8. On 7th July 2008 virtually identical objections were filed by the appellant against the two assessments. There were two grounds of objection:

(a) That the appellant was not a "close company" under section 132 of the ITA because it was recognized as a public company by the Registrar of Companies, and interest can only be deemed on a close company, which must be a private company; and

(b) Section 134 of the ITA only permits the Commissioner General to deem interest on a "loan creditor," whereas the appellant was a loan debtor in respect of the sums in question.

9. On 2nd November 2009 the respondent ruled on the objections (referring wrongly to "objection letters of 09 January 2009" – in fact those letters merely supplied information requested by the respondent subsequent to the objections lodged on 7th July 2008). The objections were wholly disallowed and it was ruled that the assessments would stand. In the letter conveying his decision, the respondent stated (although the appellant had not raised this in its objection) that:

> *"as (the appellant) has not satisfied the compliance requirements, it cannot be granted the tax benefits of an IFSC Company."*

10. He also ruled that the appellant was both a private company, and a close company. He did not deal at all with the objection that the appellant was a loan debtor and thus section 134 of the ITA did not apply to it. Nor did he make any reference to section 133 of the ITA. There was no change to the deemed interest levied.

11. The appellant lodged its appeal to the High Court on 21st December 2009, and this widened the deviation from the objections originally raised. There were four grounds, two of which were new:

(a) That the respondent erred by holding that the appellant is not and IFSC Company and that the tax certificate issued by the Minister does not apply;

(b) That he erred by misinterpreting the provisions of sections 130 and 132 of the ITA and concluding that the appellant is a close company;

(c) That he erred by insisting that sections 133 and 134 of the Act apply to the appellant; and

(d) That he erred by deeming interest in respect of loan debtors in accordance with section 134 of the ITA, which only applies to loan creditors.

12. At that stage both parties seem to have ignored or to have been unaware of the provisions of sections 91 (2) (d) and 91 (3) of the ITA, although the argument on section 91 (2) (d) was subsequently advanced by the respondent and was argued at the hearing. Section 91 (2) (d) provides that:

> *"The notice of appeal shall … be restricted to the grounds stated in the objection given to the Commissioner General except for such modifications as may be necessary arising from the partial allowance by the Commissioner General of the objection."*

13. Here the objection was wholly disallowed and was not partially allowed, so that no new grounds could be introduced. Ground (a) above was accordingly not permissible as it was not part of the original objection.

The remaining grounds fall within the range allowed by section 91 (3) of the ITA. The necessary corollary, I think, to section 91 (2) (d), is, as the appellant has argued, that the Commissioner General cannot of his own accord raise theoretical or possible objections which the appellant failed to raise, deal with these, and then expect the appeal court to rule on them. So both parties share the blame for the wrong turn taken in the appeal.

14. The error was compounded in the respondent's statement setting out the matters in dispute which was filed in terms of section 91 (4) (j) of the ITA. He first correctly listed the three such matters –

(a) whether the appellant was entitled to raise the issue of its IFSC status when this was not contained in the objection;

(b) whether the respondent is empowered by the ITA to recognize and treat the appellant as a close company for tax purposes notwithstanding the fact that the appellant is registered with the Registrar of Companies as a public company; and

(c) whether the respondent properly charged the appellant deemed interest.

15. Those issues did, by then, all require to be dealt with in the appeal. However he then went on in the Notice to present argument as to why the appellant's IFSC status should not be recognized for tax purposes. Significantly, he added, for the first time, that:

> *"The respondent concedes that he erred in deeming interest on loan debtors on the appellant in accordance with section 134 of the ITA,"*

but averred that such interest could be charged on the appellant as a loan creditor in accordance with section 133 (d) of the Act. (This indicates confusion in some of the previous averments as to whether the appellant was a loan creditor or a loan debtor. It is common cause that the assessments arose out of loans made <u>by</u> the appellant to its related companies).

16. Standing alone, the concession made would conclude the appeal. But if indeed interest could be deemed under section 133 (d) then the appeal remained arguable. The respondent did not, however, stop there. He concluded by saying that:

> *"Accordingly, whilst not qualifying to be charged deemed interest under section 134, the appellant nonetheless stands to be charged <u>deemed dividend income</u> under section 133 (d)."*

That was an entirely new issue, raised neither in the assessment, nor in the objection.

17. At a judicial case management conference called by the Judge on 18th June 2010 a consent order was made that the Court was called upon to determine

(a) whether the IFSC certificate issued to the appellant is "applicable";

(b) the (correct) interpretation of sections 130 and 132 of the ITA;

(c) whether the appellant was properly deemed to be a close company;

(d) whether the deeming provisions of sections 133 and 134 applied to the appellant; and

(e) whether interest could be deemed in respect of loan debtors under section 134.

18. These issues were unobjectionable insofar as they dealt with whether or not the IFSC point was arguable at all, and as to whether deemed interest could properly be charged as income to the appellant, as the respondent had done. They appear to ignore entirely the important concession already made by the respondent regarding deemed interest under s.134. They did not, however, authorize arguments outside the purview of section 91 (2) (d), as subsequently transpired.

19. The appeal was duly argued, the orders listed at the beginning of this judgment were made, and the present appeal was lodged.

20. The agreed bundle prepared by the parties reveals two further developments, which I shall include for completeness. The first is that on 11th July 2008 the appellant was removed from the register of companies and transferred its incorporation and domicile to Mauritius. It is no longer a resident company operating in Botswana. The second is that on 10th March 2011 the respondent served on the appellant a "demand for

withholding tax on dividend income under section 133 (1) (d) of the ITA." The total sum demanded was P58,999,581-05 which was to be paid by 29th March 2011, despite a previous agreement between the parties to await the result of the appeal before further action was taken. No new assessment or revised assessment was issued using Form ITA 22 as is the practice, and as is required by section 85 (1) of the ITA. The letter of demand contained two misleading statements. It stated that "there is nothing which prevents us from raising an assessment <u>as ordered by the court</u>" (my emphasis), and that, in terms of Order (d) "BURS <u>has to</u> charge dividend income on loans given by company to the shareholder in the year it (sic) was given under section 133 (1) (d)." (again my emphasis). In fact, the order said nothing of the sort. It merely stated that the respondent is <u>entitled</u> to apply the provisions of section 133 to the amount paid out by the appellant. I will deal with the propriety of that order shortly.

21. <u>Ground of Appeal No.1 The interpretation of sections 130 and 132 of the ITA</u>

<u>Section 130</u>

(a) Section 130 of the ITA provides insofar as is relevant to this appeal, as follows:

"130 (1) For the purposes of this Act the expression "private company", in respect of each tax year, means –

(a) a company which by its memorandum or articles of association -

(i) restricts the right to transfer its shares;

(ii) limits the number of its members to fifty, not including persons who are in the employment of the company and persons who have been formerly in the employment of the company and who were while in that employment and after the termination of that employment, members of the company; or

(iii) prohibits any invitation to the general public to subscribe for any shares or debentures of the company;

(b) a company whose membership is less than seven persons; or

(c) a company which is not recognised as a public company by the Registrar of Companies under the Companies Act.

(2) For the purposes of this Act, a company, not being a private company, shall be recognised as a public company in relation to a tax year if -

(a) (i) in the case of a resident company all classes of its equity shares are listed for quotation on the Botswana Stock Exchange on the last day of the tax year or any substituted accounting period:

Provided that in respect of a tax year prior to the establishment of the Botswana Stock Exchange all classes of its shares are listed for quotation by Stock Brokers Botswana Limited with the approval of the Interim Stock Exchange Committee appointed by the Minister; or

(ii) it is a subsidiary of a public company; or

> (iii) *it is an insurance company transacting life insurance business; or*
>
> (iv) *it is a society or company registered under the Co-operative Societies Act;*
>
> (v) *it is a Collective Investment Undertaking or Unit Trust or*
>
> (vi) *it is a specified corporation;*
>
> (b) *in the case of a non-resident company, it is recognized as a public company under the law of the country in which it is resident.*
>
> (3) __________
>
> (4) __________
>
> (5) __________
>
> (6) *Where, by reason of changes in the constitution or shareholding of any company, or for any other reason, a company which has been recognised as a public company ceases to satisfy the requirements of subsection (2) in any tax year, such company shall be recognised as a private company in relation to that tax year."*

22. Makhwade J. compressed section 130 (1) in his judgment to read:

> *"For the purposes of this Act the expression 'private company' in respect of each tax year means – a company which is not recognized as a public company by the Registrar of Companies under the Companies Act."*

He concluded, without further discussion, that the appellant was not a private company in terms of that subsection. Although that approach was accepted by both parties, I think it was oversimplified. I agree in that regard with counsel for the respondent, when he argues that a purposive interpretation is to be given to the ITA and that when interpreting ambiguous provisions the interpreter must endeavour to arrive at an interpretation which gives effect to the purpose of the provision so interpreted. In doing so, all the parts of the subsection must be considered, and not just one of the alternatives, as happened here. This was well put in **THOROUGHBRED BREEDERS ASSOCIATION vs PRICE-WATERHOUSE 2001 (4) SA 451 (SCA)**, that:

> *"The days are long past when blinkered peering at an isolated provision in a statute was thought to be the only legitimate technique in interpreting it if it seemed on the face of it to have a readily discernible meaning."*

23. In the present case, reading section 130 (1) (c) in isolation, as was done in the Court below, appears to present a clear and unassailable meaning, namely that because the appellant is recognized as a public company under the Companies Act, it is therefore not a private company for the purposes of ITA. When the subsection is read as a whole, however, and its intention is addressed, that is not necessarily so.

24. The purpose of section 130 (1) is to categorize those companies which will be recognized as private companies for the purposes of the ITA. This has particular significance in the context of sections 132, 133 and 134, which deal with "close companies," because, in terms of section 132 (1) to be a

close company, the taxpayer has to be "recognized as a private company under section 130 (1)." Section 130 (1) lists three categories of company which will be recognized as private companies for the purposes of the ITA, namely;

(a) Companies containing one or more specified restrictive provisions in their memoranda or articles of association;

(b) Companies whose membership is less than seven persons; or

(c) Companies which are not recognized as public companies by the Registrar of companies under the Companies Act.

25. These categories are stated to be in the alternative, so that if a company falls into any one of those categories it will be recognized as a private company. It matters not whether it does or does not fall into one or both of the other two categories. The alternative, looking at each category on its own, could have the effect that a company is both recognized and not recognized as a private company, by using different sub-clauses. That would be an absurd result and would not achieve the purpose of section 130 (1), which is to categorize definitively those companies which are to be recognized as private companies for the purposes of the ITA, not to list companies which will be not so recognized.

26. In this case, although the appellant has only two shareholders, I am assured that these are nominees for a wider membership, so that section 130 (1) (b) does not come into play. It is thus common cause that by

virtue of section 130 (1) (c) the appellant is not recognized as a private company for the purpose of the ITA.

27. The purpose of section 130 (2), on the other hand is to categorize those companies which will be recognized as public companies for the purposes of the ITA, and will thus enjoy the benefits and shoulder the obligations bestowed on public companies under that Act. Its purpose is not to list or define those companies which will not be so recognized. As in the case of section 130 (1) the categories are stated to be in the alternative. What is made clear, however, is that the subsection refers to companies "not being private companies," which, in its context, refers to those recognized as private companies under section 130 (1). It may or may not refer to other private companies as well, but that is not a question which need be considered here.

28. I agree with the appellant that if a company is not recognized as a public company under section 130 (2), it does not necessarily follow that it is a private company. There will be many public companies, which are clearly not private companies, but which do not qualify for section 130 (2) recognition, including all unlisted public companies. This was an error of logic made by the respondent in its submissions, and adopted by the Court in its judgment. Section 130 (6), which was used to justify this

logical (or illogical) conclusion, does indeed recognize, as Makwade J. held, that a company's status can move from that of a public company to that of a private company. But that subsection, in my judgment, creates a special category of private company for the purposes of a particular tax year only, namely of a recognized public company which ceases during that year to satisfy the recognition requirements, usually by delisting. It does not justify a conclusion that every company which does not satisfy the section 130 (2) requirements is a private company. The appellant does not qualify as a public company under section 130 (2), since it is not listed on the stock exchange. But that does not make it a private company for the purposes of the Act as it does not qualify for that under section 130 (1) either. It remains an unlisted public company. It follows that Makwade J. was incorrect, to hold that the appellant was a private company for the purposes of the ITA.

29. Section 132

Section 132 (1), which was in issue in the appeal, provides the meaning of a "close company," which is relevant for the purposes of sections 133 and 134 of the ITA. It provides as follows:

> *"132 (1) For the purposes of this section and sections 133 and 134, and subject to subsection (2), a "close company" is a resident company recognized as a private company in accordance with section (130) (1) in which a person in this section and sections 133 and*

> *134 referred to as a "participator" is, either on his or her own or with a relative or nominee –*
>
> *(a) the beneficial owner of or able to control, directly or indirectly, five per cent or over of the equity share capital of the company;*
>
> *(b) the beneficial owner, directly or indirectly, of shares in the company carrying five per cent or over of the voting powers; or*
>
> *(c) a loan creditor.*

30. The appellant argues that the Judge a quo erred in holding that it was a close company in terms of the section, since it was not recognized as a private company in accordance with section 130 (1). Only a company so recognized can be a close company, as defined. This is undoubtedly correct. Makhwade J. thus erred in holding that the appellant was a close company as well. It is not a close company. Ground of appeal No. 1 thus succeeds.

31. <u>Deemed Interest and Deemed Dividends</u>

Both section 133, which deals with deemed dividends, and section 134, which deals with deemed interest, apply only to close companies. Since the appellant is not a close company, these sections have no application to it, so that any assessment raised on the appellant arising out of either deemed interest or deemed dividends cannot stand.

32. I would add that in any event tax on deemed interest is chargeable to a participator who makes an interest free loan to a close company, and not vice versa. Even if the appellant had been a close company, as the Commissioner believed, it would not have been liable, and the respondent was right to concede the point. As regards deemed dividends these too may be charged on a participator who is in receipt of an interest free loan, and not on the close company who made loan. There is no possible interpretation of section 133 which could justify the deeming of interest, as the respondent suggested in its statement of issues.

33. <u>Ground of Appeal No. 2 – whether the IFSC issue was properly before the Court</u>

For the reasons given earlier in this judgment, Makhwade J. was correct to rule that he was precluded by section 91 (2) (d) from considering this issue, which featured in neither the assessments raised nor in the grounds of objection thereto. It was not permissible for either the appellant or the respondent to raise this fresh issue and to invite the Court to rule upon it. The purpose of section 91 (2) (d) is to crystallize and focus the issues, and it was not proper for either party in the pre-trial process, including the judicial case management process, to expand the contest and to embark upon what became a more general discussion of the appellant's tax affairs. The Judge a quo's expressed views on the substance of this matter, however cogent, must remain *obiter dicta*.

The second ground of appeal, averring that the Judge was entitled to deal with this point fails.

34. Ground of Appeal No. 3 – The Judge's powers under Section 92 (1) of the ITA

The appellant complains that Makhwade J. exceeded his powers under section 92 (1) when, in Order (d), he authorized the imposition on the appellant of tax on deemed dividends under section 133, when this was fundamentally different to the basis upon which the appealed assessments were made, and would require new assessments. There is, I think, much force in that argument. Section 92 (1) provides that:

> *"92 (1) Upon every hearing of an appeal by the Board of Adjudicators or the High Court, the Board or the Court, as the case may be, may confirm, increase, annul or order the reduction of any assessment, or may make such other order as it deems fit."*

35. There were two assessments before the Court, both relating to deemed interest. Those were the assessments to which the expression "any assessment" in the section applied. In my judgment it is those assessments, and no others, which the Court in this appeal had the power to confirm, increase, annul or reduce. It was also in relation to those

assessments, and no others, that the Court was authorized to make such other order as it deemed fit. It would be stretching literalism too far to interpret the latter provision as empowering the Judge to make unrelated orders on matters not properly before the Court, or to assume the statutory functions of the Commissioner General in making or authorizing unrelated income tax assessments. It would also negate the purpose of section 92 (1) (d) which restricts the issues (and by necessary inference the nature of the orders to be made) to those raised in the appellant's notice of objection to the impugned assessments.

36. Instead of holding that section 133 does not authorize the deeming of interest on loans, and was therefore not applicable to the appeal, the learned Judge held as follows:

> *"The respondent has submitted that section 133 (1) (d) of the Act applies to the amount loaned out by the appellant. This aspect raised an issue that required a computation of tax on an entirely new basis. Section 92 (1) of the Income Tax Act permits the Court to make any order it deems fit in the circumstances. The Court has the power to confirm, increase, amend, or order the reduction of any assessment. In the circumstances it is within the powers of the Court to order an assessment in line with the Income Tax Act including the assessment on the amount paid to the participators by the appellant. This shall be in accordance with section 133 of the Income Tax Act."*

He then proceeded to make order (d), referred to above, namely:

> *"(d) The respondent is entitled to apply the provisions of section 133 of the Income Tax Act to the amount paid out by the appellant."*

37. For the reasons set out above, this order was not proper, and falls to be set aside. It was also not proper because the appellant was not a close company, and section 133 did not apply to it. It is the function of the Commissioner General and not of the Court to issue new or revised income tax assessments. It is for the Court to adjust those, if necessary, in a properly brought appeal. If he wishes to levy tax on that different basis, the Commissioner General may issue a new or revised assessment, based on section 133, whereupon the appellant will have the right to object on pertinent grounds, if so advised. These will no doubt include that it is not a close company. They may also properly include legitimate objections not considered up to now by the Court at all, such as to whom such tax should be charged, time-bars for the issuing of assessments, whether or not the loans were made out of funds available for distribution to shareholders, and, of course, the issue of the appellant's IFSC status.

38. The time for the Court to rule on such issues will be if and when they may come before it on appeal. It is a measure of how different the new assessment was to be, that the letter of demand subsequently sent related to withholding tax on dividends deemed to be personally payable by the appellant in terms of section 58 of the ITA as read with paragraph 8 of the Seventh Schedule – a far cry from an assessment issued in

accordance with section 133 of the ITA. It was also for a totally different sum of over 50 million pula more than the original assessment.

Ground of appeal No.3 accordingly succeeds, and Order (d) cannot stand.

39. Ground of Appeal No.4 – Costs

The appellant complains that it should have been awarded costs of the appeal in the court below. This issue was properly dealt with by Makhwade J. and the point has no merit. By section 92 (2) of the ITA each party is to bear its own costs of an appeal to the High Court unless that Court is of the opinion that, either the decision of the Commissioner General was arbitrary and unreasonable, or the grounds of appeal were frivolous. The appeal was a complex one, as argued, and the learned Judge, in the exercise of his discretion found neither to have been the case. He cannot be faulted for that decision, and his Order on costs will not be disturbed.

40. Order (c) of the Court below

There is no appeal against Order (c), in which Makhwade J. ruled that "the appeal on the ground that section 134 is not applicable to loan debtors is upheld." Although the issue has not been formally raised before us, it seems clear that that order in fact finally disposed of the appeal against the two assessments of deemed interest raised against the appellant, and objected to on that ground. There was no other section under which deemed interest could be charged on the appellant, and that order effectively set aside the deemed interest sums of P23,674,247 and P26,809,363, which were all that the appellant objected to. Further argument was directed at possible tax liabilities of the appellant not reflected in any assessment nor in any objection and therefore not properly before the Court. It was Order (d) made by the Judge *a quo* which rendered this appeal necessary, and which also precipitated the offending letter of demand for P58,999,581-05.

It is clear from all that has gone before that the appeal must succeed.

41. In terms of section 93 (3) of the ITA this Court may make such order as to costs as it deems fit. Since the stakes were high and the issues fairly complex the appellant cannot be faulted for engaging two counsel, and it is entitled to its costs of this appeal.

42. The Order of the Court is as follows:

(1) The appeal succeeds.

(2) The Orders of the Court below are set aside, and are replaced with the following Order:

(a) The appeals against the dismissal of the appellant's objections to assessments No.s 2/2005 and 2/2006, both dated 16th May 2008 are upheld.

(b) The deemed interest assessed in the sums of P23,674,247 and P26,809,363 respectively is set aside.

(c) Each party shall pay its own costs.

(3) The respondent shall pay the appellant's costs of this appeal, including the costs of two counsel.

DELIVERED IN OPEN COURT AT LOBATSE THIS 10TH DAY OF FEBRUARY 2012.

I.S. KIRBY
JUDGE PRESIDENT

I AGREE

S.A. MOORE
JUSTICE OF APPEAL

I AGREE

E.W.M.J. LEGWAILA
JUSTICE OF APPEAL