IN THE COURT OF APPEAL OF THE DEMOCRATIC SOCIALIST REPUBLIC OF SRI LANKA

In the matter of an application of a Case Stated under Reference No. TAC/VAT/012/2012 by the Tax Appeals Commission under Section 36 of the Value Added Tax Act No. 14 of 2002 as amended

Kegalle Plantations PLC,

310, High Level Road,

Nawinna, Maharagama

APPELLANT

Case No. CA (TAX) 02/2014

Tax Appeals Commission Case No.

TAC/VAT/012/2012

Vs.

The Commissioner General of Inland Revenue,

Department of Inland Revenue,

Sir Chittampalam A. Gardiner Mawatha,

Colombo 02.

RESPONDENT

Before: Janak De Silva J.

N. Bandula Karunarathna J.

Counsel:

F.N. Goonewardena for the Appellant

Farzana Jameel P.C. ASG with Chaya Sri Nammuni SSC for the Respondent

Written Submissions tendered on:

Appellant on 22.12.2016

Respondent on 17.02.2017

Argued on: 24.01.2020

Decided on: 08.06.2020

Janak De Silva J.

The Appellant is a public quoted company engaged in the cultivation, manufacture and sale of tea, rubber, coconut, cardamom and other agricultural products. The land covered by the plantation of the Appellant is owned by the State and given to the Appellant on a long-term lease.

The issue involved in this matter is whether the income received from the sale of old rubber trees removed from the existing rubber plantation of the Appellant under the rubber re-plantation program of the Appellant is liable for Value Added tax (VAT), in terms of the Value Added Tax Act No. 14 of 2002 as amended (VAT Act).

The Tax Appeals Commission (TAC) has forwarded the following questions of law as part of the Case Stated:

1. Are any of the assessments from the subject matter of this appeal invalid and bad in law by reasons of the Inland Revenue Department failing to comply with the provisions of section 29 of the VAT Act?

2. Has the Tax Appeals Commission erred in concluding that the agreements entered into by the Appellant with contractors titled "Agreements for uprooting Old Rubber Trees and Clearing the Land" were in fact contracts for the supply of timber logs?
3. Has there been a "taxable supply of goods" by the Appellant in relation to rubber trees under the aforesaid agreements, in terms of the VAT Act?
4. Would the supply of Rubber trees in terms of the aforesaid agreements be an exempt supply in terms of the VAT Act by reasons of it being:
    a. "Unprocessed agricultural products produced in Sri Lanka" within the meaning of item (b) (xxiii) of Part II of the First Schedule of the VAT Act;

    or

    b. "Agricultural plants" in terms of item (a)(xi) of Part II of the First Schedule of the VAT Act?
5. Would the supply of rubber trees in terms of the aforesaid agreements:
    a. be exempt from VAT by reason of it being in the nature of capital goods used in making exempt supplies within the meaning item (a) (i) of Part II of the First Schedule of the VAT Act; or
    b. be outside the scope of the VAT Act by reason of it being in the nature of capital goods?

At the outset we observe that this is a Case Stated submitted for the opinion of this Court by the TAC under section 36 of the VAT Act. Although neither party raised this issue, we note that the VAT Act was amended by the Tax Appeals Commission Act No. 23 of 2011 as amended (TAC Act) by the repeal of section 36 therein. Hence the TAC has made a reference to this Court under a repealed provision.

However, it is well-settled that an exercise of power will be referable to a jurisdiction which confers validity upon it and not to a jurisdiction under which it will be nugatory. This principle has been applied even to cases where a Statute which confers no power has been quoted as authority for a particular act, and there was in force another Statute which conferred that power. [*Pieris v. The Commissioner General of Inland Revenue* (65 N.L.R. 457), *Kumaratunga v. Samarasinghe, Additional Secretary, Ministry of Defence and Others* (1983) 2 Sri.L.R. 63].

Section 11A of the TAC Act enables the TAC to refer for the opinion of this Court a Case Stated. Accordingly, we are of the opinion there is a valid reference and make our determination accordingly.

Although five questions of law were referred to Court by the TAC, the learned counsel for the Appellant acting in the best traditions of the Bar as always, informed that the Appellant limits its arguments to the questions of law nos. 2 and 4(a) and 4(b).

Nature of the Contracts

The Appellant has entered into several contracts with contractors for the uprooting and removal of rubber trees. A sample of one such contract has been marked as R2 in the brief. In terms of the contract R2, the Contractor has to pay the Appellant a sum of Rs. 1,600/= per tree. The entire responsibility of uprooting and the removal of the tree is the responsibility of the Contractor. It goes on to specify that the Contractor must remove everything from the ground which include even the roots which are the size of pencils.

The contention of the learned counsel for the Appellant is that the contracts are in effect contracts for the sale of rubber trees *in situ* (i.e. live rubber trees in the natural form) and the successful bidder has paid the full sale consideration when the trees are in live form and live trees are "unprocessed agricultural product", which is an exempt supply within item (b)(xxiii) of Part II of the First Schedule to the VAT Act. In the alternative the Appellant contends that it sold agricultural plants which is an exempt supply within item (a)(xi) of Part II of the First Schedule to the VAT Act.

The analysis must begin with the interpretation of the contracts the Appellant entered into with Contractors. In this exercise, it must be borne in mind that *"interpretation is the ascertainment of the meaning which the document would convey to a reasonable person having all the background knowledge which would reasonably have been available to the parties in the situation in which they were at the time of contract"* and that *"the meaning which a document ... would convey to a reasonable man is not the same thing as the meaning of its words. The meaning of words is a matter of dictionaries and grammars; the meaning of the document is what the parties using those words against the relevant background would reasonably have*

been understood to mean." [per Lord Hoffmann in *Investors Compensation Scheme Ltd., v. West Bromwich Building Society* (1998) 1 All. E. R. 98 at 114-115]. In fact, this approach appears to have been adopted by Sampayao J. much earlier in *Gunatilleke v. Simon Appu* [(1918) 2 C.L. Rec. 11] when he held that *"a court of justice in construing a document should have less regard to its letter that to its general sense and intention."*

In this context it is important to determine the true nature of the contracts entered into by the Appellant. The substance test has been used by courts to determine whether a contract is a contract for the sale of goods or contract for the supply of services [per Greer L.J. in *Robinson v. Graves* [(1935) 1 KB 579 at 587; Atiyah, Adams and Macqueen, *The Sale of Goods* (11th Ed.; page 27)]. We are of the view that the same test is appropriate in determining the true nature of the contract in issue.

The true nature of the contracts entered into by the Appellant can be discerned only after scrutinizing its terms and conditions. The Appellant called for public tenders for "Uprooting Old Rubber Trees". The agreement R2 states that it is for the "uprooting and removal of trees". It lays down several conditions which regulate the manner in which the contractors must perform their part of the bargain. It requires the contractor to uproot and clear old rubber trees. The contractor has to pay the Appellant a sum of Rs. 1600/= per tree. Furthermore, the contractor is required to deposit a sum of Rs. 50/= per tree as a security deposit to ensure the due uprooting and removal of the tree. Where the contractor fails to duly clean the land, the security deposit is forfeited.

The learned counsel for the Appellant submitted that in terms of section 2(1)(a) of the VAT Act, VAT is chargeable *at the time of supply* and that in terms of section 4(1) of the VAT Act the time of supply is deemed to be the earlier of payment or delivery.

The learned counsel for the Appellant then referred to several clauses in the agreement R2 and contended that they evidence that (i) at the time of signing the agreement the contractor is required to make a deposit of Rs. 50/= per tree which is to prevent him from defaulting on the agreement; and the contractor is required to pay the full sum payable in respect of the number of trees he intends to remove, and he would only be entitled to remove the trees after he has

paid for the full value of the trees. Accordingly, he contended that the supply for the purpose of the VAT Act in the instant case was complete whilst the tree was *in situ* and therefore the contract must be construed as being one for the supply of live trees in their natural form which is an exempt supply.

We are of the view that this proposition is not tenable in law. The Appellant called for tenders to uproot and remove **non-harvesting rubber trees**. Hence, the trees sold have ceased to be productive in their natural form. Furthermore, section 4(1) of the VAT Act reads:

> "The supply of goods shall be deemed to have taken place at the time of occurrence of any of the following whichever, occurs earlier; (a) the issue of an invoice by the supplier in respect of the goods; or (b) a payment for the goods including any advance payment received by the supplier; or (c) a payment for the goods is due to the supplier in respect of such supply; or (d) the delivery of the goods have been effected."

The meaning of the word "deemed" was considered and explained by Ranasinghe, J. (as he then was) in *Jinawathie v. EmalinPerera*[(1986) 2 Sri.L.R. 121 at 130,131] in the following words:

> "In statutes, the expression deemed is commonly used for the purpose of creating a statutory function so that a meaning of a term is extended to a subject-matter which it properly does not designate. . . Thus, where a person is deemed to be something it only means that whereas he is not in reality that something, the Act of Parliament requires him to be treated as if he were".

Section 4(1) of the VAT Act is a deeming provision to determine the time of supply for the purposes of section 2(1) of the VAT Act. VAT is charged at the time of supply and as such it is important to clearly identify the time at which the taxable supply of goods or services takes place. Section 4(1) of the VAT Act seeks to facilitate the identification of this point of time. The deeming effect is in our view restricted to ascertaining the time of supply for the purpose of charging VAT.

It cannot be used to establish that the supply of goods did in fact take place at that point of time. In terms of section 83 of the VAT Act "supply of goods" means the passing of exclusive ownership of goods to another as the owner of such goods. Hence for there to be a "supply of goods" there must be a passing of "exclusive ownership of goods". That in our view must be ascertained upon a consideration of the provisions in the Sale of Goods Ordinance dealing with the passing of property.

The learned counsel for the Appellant concedes this point in submitting that the Sale of Goods Ordinance applies to the relevant contracts in relation to when the property or title to the underlying goods passes. However, he contends that the goods forming the subject matter of the contracts are specific or ascertained goods and that in terms of section 18 of the Sale of Goods Ordinance, the property is transferred to the buyer at such time the parties to the contract intend it to be transferred.

We are of the view that the goods forming the subject matter of the contracts between the Appellant and his contractors are not specific or ascertained goods but unascertained goods. The contracts do not identify the particular trees to be cut. It refers only to the number of trees. The contracts require the contractor to take over the trees that are identified by the field officer. Hence the goods remain unascertained as at the date of payment and passing of "exclusive ownership of goods" did not for the purposes of the Sale of Goods Ordinance take place at the date of payment as submitted by the learned counsel for the Appellant.

Section 19 of the Sale of Goods Ordinance sets out different rules for ascertaining the intention of the parties as to the time at which the property in the goods pass to the buyer unless a different intention appears from the terms of the contract, conduct of the parties and the circumstances of the case. Rule 5 specifies that where there is a contract for the sale of unascertained or future goods by description, and goods of that description and in a deliverable state are unconditionally appropriated to the contract, either by the seller with the assent of the buyer or by the buyer with the assent of the seller, the property in the goods thereupon passes to the buyer. In *Kursell v. Timber Operators & Contractors Ltd.* [(1927) 1 K.B. 298] the plaintiff sold to the defendants all the trees in a Latvian forest which conformed to certain

measurements on a particular date, the buyer to have 15 years in which to cut and remove the timber. The English Court of Appeal held that the property in the trees did not pass to the defendants as the goods were not sufficiently identified.

In the instant case, exclusive ownership of the trees did not pass when the payment was made by the contractor as the goods remain unascertained. The property in the trees can be passed if at all only after the trees are ascertained by the field officer as stated above.

As long as the trees are *in situ* on land owned by the State property in them cannot be transferred to the contractor. The property in them can be transferred only after uprooting them. In these circumstances, the true nature of the contracts in substance is that they are for the uprooting and removal of trees for the supply of rubber logs. The consideration for these contracts was the timber value of the trees uprooted, removed and taken into the possession of the contractor.

Accordingly, we reject the argument made by the learned counsel for the Appellant that the contracts are in effect contracts for the sale of rubber trees *in situ*.

We further conclude that there has been a "taxable supply of goods" by the Appellant in terms of the VAT Act in relation to rubber trees under the aforesaid agreements.

Unprocessed Agricultural Product/Agricultural Plant

The learned counsel for the Appellant submitted that even if the Respondents argument was to be accepted namely that the supply could only take place after the trees were uprooted and cut, whether the mere uprooting and cutting of the tree for removal from the estate could be considered to be "processing" which would disentitle the Appellant to the exemptions referred to in section 7 of the VAT Act which are available for an "unprocessed agricultural product" or "agricultural plant" needs to be considered.

In addressing this contention Court is called upon to interpret the provisions of the VAT Act to ascertain whether the activity of the Appellant under consideration is subject to VAT. In *Perera & Silva Ltd., v. Commissioner General of Inland Revenue* [79(II) N.L.R. 164 at 167] Thamotheram J. quoted with approval the following statement in C. N. Beatie- Elements of the Law of Income and Capital Gains Taxation at page 2;

> "It has frequently been said that, there is no equity in a taxing statute. This means that tax being the creature of statute, liability cannot be implied under any principle of equity but must be found in the express language of some statutory provision. The ordinary canons of construction apply in ascertaining the meaning of a taxing statute: "the only safe rule is to look at the words of the enactments and see what is the intention expressed by these words." *If in so construing the statute the language is found to be so ambiguous that it is in doubt whether tax is attracted or not, the doubt must be resolved in favour of the taxpayer, because it is not possible to fall back on any principle of common law or equity to fill a gap in a taxing statute.* "The subject is not to be taxed unless the words of the taxing statute unambiguously impose the tax upon him ". However, this does not prevent the court from construing a taxing statute against the subject, where that appears to be the correct interpretation of a provision the meaning of which it may be difficult to understand. *Difficulty does not absolve the court from the duty of construing a statute; it is only when ambiguity remains after the statute has been properly construed that the court is entitled to decide in favour of the taxpayer".* (Emphasis added)

The Appellant contends that the mere act of cutting or felling trees would not amount to "processing". The learned counsel for the Appellant contended that the term "processed" connotes the performance of a series of mechanical or chemical operations on an object in order to change or preserve its original form and the mere act of cutting the tree would not change or modify the essential character of the tree and therefore cannot be construed as "processing".

Reliance was placed on the term "unprocessed agricultural product" and the opposing term "processed agricultural product" used in Title 7 of the U.S. Code, European Union Regulation No. 510/2014 and United Kingdom Consumer Protection Act of 1978 and it was submitted that in all such contexts the envisaged processing would not cover the mere act of cutting down or felling an agricultural product such as a live tree.

We note that even these legislative instruments do not support the proposition advanced by the Appellant and does not have a common meaning attributed to the word "unprocessed agricultural products". While in Title 7 of the U.S. Code "processing" appears to imply doing an act which makes the product retail ready, the European Union Regulation No. 510/2014 appears to require steps such as adding chemicals or breaking down or otherwise changing the character of the agricultural product.

Hence the legal meaning of a word changes from jurisdiction to jurisdiction depending on its context and the intention of the legislature. We are of the view that it is unsafe to define a word used in the domestic legislation merely by reference to the same word and its meaning in different foreign legislative instruments.

The learned counsel for the Appellant referred to the Guide to the Value Added Tax in Sri Lanka and submitted that the directions issued by the Respondent defines "unprocessed agricultural produce" to include live trees, and other plants, roots, branches, leaves, flowers, tubes, seeds, fruits and nuts of trees and other plants in natural form not otherwise processed. He contended that manifestly live trees are caught up within the definition of unprocessed agricultural produce and that the Respondent is estopped from taking up a contrary position.

In terms of Article 23(1) of the Constitution, all laws are enacted and published in the Sinhala and Tamil, together with a translation thereof in English. Any interpretation of the VAT Act must be therefore be done by reference to the Sinhala Act as section 84 therein states that the Sinhala text shall prevail where there is any inconsistency between the Sinhala and Tamil texts and as the English text is only a translation.

The term used in the Sinhala text for "unprocessed" is "සැකසුම් නොකළ". We are of the view that the term "සැකසුම් නොකළ" is not a term of art as used in the VAT Act and must be given a literal meaning. In ගුණසේන මහා සිංහල ශබ්දකෝෂය compiled by Harischandra Wijetunge (2005, 1st Ed.) the word "සැකසීම්" is defined as නාප්‍ර සකසනවා යන්නෙහි භා නාපිළියෙල කිරීම, විශේෂ ක්‍රමයකට පිළියෙල කිරීම, සුදුසුසේ ගලපා සෑදීම් කිරීම, සැකැස්ම.

The subject matter of the contracts between the Appellant and his contractors are not in our view live trees. The true nature of the contracts in substance is that they are for the uprooting and removal of trees for the supply of rubber logs. The consideration for these contracts was the timber value of the trees uprooted, removed and taken into the possession of the contractor. The exemption from VAT given to "unprocessed agricultural product" does not cover the instant case where non-harvesting rubber trees are uprooted and removed. That involves a process which changes the subject from a rubber tree to firewood, logs and chips.

Accordingly, the subject matter of the contracts between the Appellant and its contractors are not live trees within the meaning of the Guide to the Value Added Tax in Sri Lanka. It is also not "unprocessed agricultural product" within the meaning of item (b) (xxiii) of Part II of the First Schedule of the VAT Act.

The remaining question is whether the subject matter of the contracts between the Appellant and the contractors are "Agricultural plants" in terms of item (a)(xi) of Part II of the First Schedule of the VAT Act.

In the Sinhala text of the VAT Act, the word used in item (a)(xi) of Part II of the First Schedule is "කෘෂිකාර්මික පැල". In ගුණසේන මහා සිංහල ශබ්දකෝෂය compiled by Harischandra Wijetunge (2005, 1st Ed.) the word "පැල" is defined to mean "පැළනාප්‍රග1 කුඩා ශාකය, ළපටි ගස, ළදරු ගස2 බස්නාහිර දිසාව 3 පිටිසස්ස 4 පීඩාව, පෙ ම. ව. ළපටි, ළදරු". Non-harvesting rubber trees of around 27 to 30 years old which according to the Appellant were sold and profits derived as "Sales of firewood, logs and chips" are not in our view "කෘෂිකාර්මික පැල" within the meaning item (a)(xi) of Part II of the First Schedule of the VAT Act.

Accordingly, we answer the questions of law arising in the Case Stated as follows:

2. Has the Tax Appeals Commission erred in concluding that the agreements entered into by the Appellant with contractors titled "Agreements for uprooting Old Rubber Trees and Clearing the Land" were in fact contracts for the supply of timber logs? **No.**

4. Would the supply of Rubber trees in terms of the aforesaid agreements be an exempt supply in terms of the VAT Act by reasons of it being:

    a. "Unprocessed agricultural products produced in Sri Lanka" within the meaning of item (b) (xxiii) of Part II of the First Schedule of the VAT Act? No.

    or

    b. "Agricultural plants" in terms of item (a)(xi) of Part II of the First Schedule of the VAT Act? No.

Accordingly, acting in terms of section 11A (6) of the TAC Act, we confirm the assessment determined by the TAC.

The Registrar is directed to send a certified copy of this determination to the Secretary of the TAC.

Judge of the Court of Appeal

N. Bandula Karunarathna J.

I agree.

Judge of the Court of Appeal