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

In the matter of an appeal on a question of law in terms of Value Added Tax Act No. 14 of 2002 read together with the Inland Revenue Act No. 10 of 2006.

Court of Appeal Case No:
TAX 11/2010
Board of Review Case No: BRA/VAT-05

Senvec Lanka (Pvt) Limited,
No. 28,
Ramakrishna Road,
Colombo 06.

Appellant

Commissioner General of Inland Revenue,
Department of Inland Revenue,
Sri Chittampalam A. Gardiner Mawatha,
Colombo 02.

Respondent

Before: **D.N. Samarakoon,J.**
B. Sasi Mahendran, J.

Counsel: Nihal Fernando PC with Johan Correra for the Appellants
C. Sri Nammuni, DSG with Navodi de Zoysa, SC for the Respondent

Written Submissions On : 20.07.2018 (by the Appellant)
13.07.2018 (by the Respondent)

Argued On : 30.10.2023

Decided On : 28.02.2024

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B. Sasi Mahendran, J.

This is an appeal against a Determination of the Board of Review relating to the provisions of the Value Added Tax Act, No. 14 of 2002 (hereinafter referred to as VAT). The appeal relates to three quarterly taxable periods ending 31.12.2002, 31.03.2003, and 30.06.2003.

The Appellant, Senvec Lanka (Pvt) Limited, is a private limited liability company engaged, inter alia, in the business of supply and maintenance of colour sorting machines in Sri Lanka from Japan, by agreement dated 26.06.1996, purported to act as the sole agent of Hattori Sei Sakusho Co. Ltd of Japan.

The Appellant submitted VAT returns for the quarterly taxable periods ending 31.12.2002, 31.03.2003, and 30.06.2003 and claimed an exemption under Section 7 (1) (c) of the VAT Act.

The Assessor rejected the returns, and the Appellant, being dissatisfied with this rejection, appealed to the Commissioner General of Inland Revenue (hereinafter referred to as the "CGIR").

The CGIR, in his determination dated 08.06.2006, determined that the appellant is not entitled to the exemption on the basis that the service for which the Appellant received the commission was consumed inside Sri Lanka and dismissed the appeal.

The Appellant, being aggrieved by this decision, appealed to the Board of Review. The Board of Review, in its Determination, having considered the submissions of the representatives appearing for the Appellant and officials representing the CGIR, confirmed the assessments and dismissed the appeal for the reasons set out in its Determination dated 12.01.2010, thereby confirming the decision of the CGIR.

Dissatisfied with this Determination of the Board of Review, the Appellant, through its communication dated 09.02.2010, requested the Board to have a Case Stated for the Opinion of this Court. Initially, the case stated, remitted by the Appellant to this Court, contained three questions of law. Subsequently, it was agreed between the parties to amend these questions, resulting in the following 10 questions of law:

i. Has the Board of Review failed to consider the Sole Agency Agreement entered between the Principal and the Appellant?

ii. Has the Board failed to consider the effect of more particularly clauses 2(b), 2(d), 2(f), 3(a), 3(b) and 3(c) of the Agreement between the Appellant and Principal?

iii. Has the Board of Review failed to consider the primary objects of the Appellant in part or in its totality?

iv. Has the Board of Review failed to ascertain the services consumed by the Principal in Japan in order to consider whether such services can be zero rated under Section 7(1) (b) (vii) if the VAT Act?

v. Has the Board of Review misdirected itself and/ or erred in determining that the quotations issued by the Appellant on behalf of the Principal are 'offer documents as the importer?

vi. Has the Board of Review erred or misdirected itself in determining that the aforementioned 'quotations' have created contractual obligations between the Appellant and the prospective importers of Colour Sorting machines?

vii. Is the additional assessment for the quarter ending 31.03.2003 as confirmed by the Board of Review invalid by reason that Section 2 read with Section 31 of the VAT Act requires assessments to be made separately for each taxable period?

viii. Is the additional assessment for the quarter ending 31.03.2003 invalid by reason of the Commissioner General of Inland Revenue (CGIR) failing to consider the time of supply of each supply as required by Section 4 of the VAT Act?

ix. Are the additional assessments for the quarters ending 31.12.2002 and 31.03.2003 invalid since the relevant services are zero rated under Section 7(1)(b)(vii) of the VAT Act?

x. Has the Board of Review failed to consider and/or misdirected itself in determining whether the services rendered by the Appellant to the Principal should be considered as services consumed by the Principal outside Sri Lanka as determined in the judicial precedents of *WYven UK Marketing Ltd. V The Commissioners (1975) VAT Tribunal Reports 52* and *Kidd & Zigrino Ltd. V. The Commissioners (1974) VAT Tribunal Reports 173* cited before the Board?

At the outset, it should be noted that the questions of law refer to section 7(1) (b) (vii) of the VAT Act. However, according to our understanding section 7(1)(b)(vii) of the VAT Act is not relevant to this case.

For clarity I will reproduce section 7(1)(b)(vii) of the VAT Act here:"*the provision of services to overseas buyers by a garment buying office registered with the Textile Quota Board established under the Textile Quota Board Act, No.33 of 1996, where payment for such service is received in foreign currency, through a Bank of Sri Lanka in so far as such services are identified by the Commissioner-General as being services essential for facilitating the export of garments to such overseas buyers"*

The relevant provision to this case, instead, is section 7(1)(c) of the VAT Act.

There are two issues before us to determine in this appeal:

(i) According to the case stated, whether the Appellant is a principle or an agent

(ii) Whether the services for which the Appellant received commission was consumed or utilized outside Sri Lanka

(i) Whether the Appellant is an agent or a principal:

According to the determination made by the CGIR dated 08/06/2006, he has stated the reasons for his decision:

"Accordingly, the Appellant's only function was to provide services to the principal in Japan. (Hattori Seisolusho Co Ltd) The appellant's function is not limited to supplying advice to the principal. Supplying advice alone would not result in the payment of commission… According to the agreement commission would not be paid if machineries and spare parts were not supplied in Sri Lanka and if Payments for such supplies were not realized in Japan. It is the responsibility of the Appellant to install the machinery in Sri Lanka. Otherwise, machinery would have been of no value to the customers. Such services were not supplied for the use of person outside Sri Lanka and they are directly connected with the goods supplied in Sri Lanka.

In addition, under the above conditions of the agreement the Appellant ***acted as principal and not as an agent*** *and carries out a taxable activity in Sri Lanka. The services supplied by the Appellant were directly connected with the goods in Sri Lanka and*

therefore treated as consumed in Sri Lanka and should not be treated as consumed outside Sri Lanka. Hence, those services should not be taxed at zero rate. Therefore, only the commission on sale of machinery overseas and overseas installation charges are treated at zero rate".

The Board of Review in their determination dated 12.01.2010 also stated the same:

" We find from an examination of the document marked Aannexure-1 submitted with the written submission by the Appellant dated 23.06.2009 discloses that the appellant has acted independently by itself and not as the Agent in the sale of Senvec Colour Sorting machines in Sri Lanka. The Appellant opens letters of credit in its name and all shipping documents such as invoices, bills of lading etc are in the name of Appellant. On arrival of goods in Sri Lanka, the Appellants submits Cus-Decs to the Customs to clear the goods and delivers them to various destinations. Thus it is seen that the services supplied by the Appellant are so directly connected with the goods as a direct importer"

Therefore, the Board of Review holds the view that the Appellant did not act as an agent but instead functioned as a principal.

However, upon examining the Sole Agency Agreement between the Appellant and the Principal, the following facts come to light:

Hattori Seisakusho Co. Ltd of Japan, the foreign Principal in this case, is an established supplier of Colour Sorting Machines and similar machinery. These machines are custom-made to meet their clients' specific requirements, particularly catering to the ultimate user's expectations.

The Appellant Company is the sole indenting agent for the Principal's Colour Sorting Machines in Sri Lanka. In 1996, the Appellant entered into a Sole Agency Agreement with the Principal, which appointed the Appellant as the sole agent of the Principal for a period of 10 years. According to Clause 1 of the said agreement, which is available in the brief, the Appellant functioned as an Agent for Sales, Service, and Maintenance of the Principal's Senvec Colour Sorting Machines.

As stipulated in the Sole Agency Agreement between the Principal and the Appellant, the Appellant received a commission from the Principal for indenting, promotional services, and market information provided by the Appellant in relation to the Colour Sorting Machines that were exported and supplied directly by the Principal to customers in Sri Lanka.

For clarity, Clause 2(b) & (c) of the said Agreement are reproduced:

2(b) "*That during the currency of this Agreement, the Principal will not* ***sell*** *or otherwise* ***deal*** *in its Colour Sorting Machines in the "Agent's Territory" through* ***any other*** *Agent/Dealer." (emphasis added)*

2(c) "That any orders or ***enquiries*** *relating to the Agent's Territory'* ***received*** *by the Principal during the currency of the Agreement,* ***will be passed on to the Agent*** *to be dealt with".*

This clearly shows that even when the Principal receives an order directly, they will redirect the order to the Appellant to proceed.

As per Clause 2(f)(i) and (ii) of the said Agreement between the Appellant and the Principal, the mutually agreed commission is paid by the Principal to the Appellant only in respect of machines supplied directly by the Principal to the customers in Sri Lanka.

For clarity the relevant clause of the Sole Agency Agreement is reproduced as follows:

"2 (f) (i) That the Principal will remit to the Agent in Sri Lanka the mutually agreed Commission on the realization of Payment in Japan in the respect of each machine and for any Spare Parts supplied directly to the Customers within the said territory. The minimum quantities if any for such spare part orders will be advised by the Principal on receipt of each request.

(ii) ***No Commission shall be payable*** *for Spares* ***directly imported*** *by the Agent and sold or marketed within the said territory"*

A plain reading of this clause suggests that the contract or the sale of direct supplies is made directly between the Principal and the customers. Furthermore, Clause 2(f) (i) of the Sole Agency Agreement states that the commission received by the Appellant Company as an Agent will only be realized upon the payment in Japan for machines and spare parts supplied directly by the Principal to the customer.

The Appellant contends that the Proforma Invoice represents the first step in the process of importing goods, signifying the contract between the buyer and the seller. The fact that the Proforma Invoice is issued in the name of the local customer and the payment via Letter of Credit is made directly to the Principal confirms that the material supply/transaction concerning machines and spares supplied directly involves the Principal and the customer.

The Sole Agency Agreement, upon a plain reading, suggests that supplies made directly to the customer by the Principal, for which the Appellant received commission, are distinct from transactions where the Appellant acts as an importer, as provided in Clause 2(f) (ii) of the Agreement. It should be noted in this regard that this clause of the Agreement clearly states that no commission shall be payable where the Appellant acts as an importer, directly importing, selling, and marketing Spare parts in Sri Lanka.

The Appellant submits that, when acting as an importer of spare parts and providing services such as maintenance, the Appellant invoices the local customer. In these sales, the Appellant does not receive a commission, in accordance with the Agreement.

It is the opinion of this Court that the Board of Review has misinterpreted the Clauses of the Sole Agency Agreement in determining that the Appellant acted as a principal and not as an agent.

According to Black's Law Dictionary (B. A. Garner and H. C. Black, Black's Law Dictionary, Ninth Edition, 2009, p.1177), an "agent" is defined as 'one who is authorized to act for or in place of another; a representative.'

As discussed earlier, Clause 1 of the Sole Agency Agreement clearly states that the Appellant functioned as an Agent for Sales, Service, and Maintenance of the Principal's Senvec Colour Sorting Machines.

It should be noted that Nawas J, in the case of Senvec Lanka (Pvt) Ltd v. CGIR, CA Case No. Tax 05/2010, a case concerning an application of turnover involving the same Appellant company and the CGIR, discussed whether the Appellant was acting as an agent. It was determined that the Appellant was indeed acting in the capacity of an agent.

I would like to quote the very statement of Nawaz J at this point:

"*The Agency Agreement (P2) which is at page 68-76 of the appeal brief is demonstrative of the functions carried on by the Appellant. It shows that the Appellant functioned as an agent of Hattori Seisakusho Co. Ltd, Japan. The Appellant canvassed orders on behalf of the Principal for which the principal agreed to ""remit to the Agent in Sri Lanka the mutually agreed Commission on the realization of the payment in Japan"*

Nawas J Further held that:

"In international trade a Pro-forma Invoice is a preliminary bill of sale sent to buyers in advance of shipment of delivery of goods. Typically, it gives a description of the purchased items and notes the cost along with other important information, such as shipping weight and transport charges. This document gives an indication as to the status of the Appellant. This document strengthens the position of the Appellant that he was not acting in any character otherwise than as an agent."

His Lordship further held that,

"*From the foregoing analysis of the transactions and the applicable law it is quite clear that there is no import on the part of the Appellant. The document p4 at page 61 shows that the Appellant charges a commission from the customer for facilitating the opening of the Letter of Credit (items 'B' and 'C' in p4), Clearing Charges (vide 'D','F', 'G', 'H', "I' and 'J' in P4 at page 61 of the brief). The Appellant also charges the Customer for transportation and installation (vide: items 'K' and 'L' in P4). Installation takes place at a cost to the customer as under Clause 2(f) of the Agency Agreement the Appellant is entitled to a commission".*

In Amadeus Lanka (Private) Limited V. Commissioner General of Inland Revenue, CA No. CA/TAX/04/2019 decided on 30.07.2021, Sampath K. B. Wijeratne J held:

"On a careful consideration of the aforementioned clauses, I am of the view that ALANKA, with the authority granted by AIPL, provides its services directly to the subscribers in Sri Lanka, and the services are utilised within Sri Lanka. On the above analysis of facts, it is my considered view that the TAC has correctly held that ALANKA is an agent of AIPL."

Therefore, it is clear that the Board of Review has misinterpreted the Sole Agency Agreement in their determination that the Appellant was not an agent of the Principal,

but rather a principal himself. Accordingly, in answering questions of law Nos. (i) and (ii), we hold that the Board of Review has incorrectly interpreted the Appellant as the Principal. The Appellant is solely the Agent to the Principal in Japan.

(ii) Whether the services for which the Appellant received commission were consumed or utilized outside Sri Lanka

The question that needs to be answered in this matter is whether the supply of service made by the Appellant is zero-rated in terms of Section 7 (1) (c) of the VAT Act, as amended. According to Section 7 (1) (c) of the VAT Act, the Appellant has to establish that the service provided by the Appellant was consumed or utilized outside Sri Lanka.

In the Appellant's written submission dated 22/12/2023, specifically in paragraphs 31, 32, and 33, it is stated that the Appellant functioned as an agent for (i) sales, (ii) servicing, and (iii) maintenance. The Appellant contends that he received commission from the foreign principal for indenting, promotional services, and market information provided by the Appellant in relation to the machines. Once the local customer makes a payment, the principal proceeds with the order and directly sells the machinery to the customer. The foreign principal decides to export to the local customer only on the recommendation of the Appellant.

Clause 2(c) of the Agreement clearly states: "That any orders or enquiries relating to the Agent's Territory received by the Principal during the currency of the Agreement, will be passed on to the Agent to be dealt with."

As the Appellant has rightly submitted, according to the Sole Agency Agreement, the direct supply of the machinery is done by the Principal in Japan based on the information provided by the Appellant, and thereafter the Appellant receives the mutually agreed commission if the sale is successful.

Clause 3(b) of the Agreement states that the service provided by the Appellant to the Principal involves promoting the Principal, taking orders from local customers, and communicating their specific customized needs to the Principal. For clarity, the same clause is reproduced as follows:

"3(b) that they will use best efforts and endeavors at all times during the currency of this Agreement to promote the sale of the products covered by this Agreement. The Agent shall forward promptly to the Principal any and all orders obtained by the agent with complete details" (emphasis added).

According to our understanding, the term "promote the sale of products" refers to providing information about the customers and their needs to the Principal.

It is acknowledged that Clause 1 of the Agreement appoints the Appellant as the "sole and exclusive Agent for the Sale, Servicing, and Maintenance" of the 'Senvec' Colour Sorting Machines and Spares in Sri Lanka. Additionally, by Clause 2(h) of the same Agreement, the "Principal agrees that the Agent may, at his discretion, invoice the customers for services such as Installation, Maintenance, and Breakdown services. Therefore, it is evident that the service provided by the Appellant to the Principal, for which the Appellant received commission under Clause 2(f) (i) of the Agreement, involves securing orders for the Principal from customers in Sri Lanka and communicating all orders received to the Principal with the specific customized needs.

It is crucial to note that even if the Appellant refers a customer to the Principal, the Appellant will receive a commission only where the ordered machinery or spare parts are directly supplied by the Principal to the customers.

Thus, the indenting, promotional services, and market information are provided by the Appellant as the Agent of the Principal, and the recipient of such service is the Principal itself. It is observed that the commission is paid to the Appellant under the Sole Agency Agreement for providing information about the customers and communicating the specific customized needs of the customers to the Principal.

From the detailed analysis of the Sole Agency Agreement between the Appellant and the Principal, it is clear that the primary service for which the Appellant received commission was to provide information to the Principal, secure orders for the Principal, and relay the specific customized needs of the local customers. The primary commission received from the Principal was for the service of providing information about customers and their needs.

The CGIR, considering the judgment in the case of Wyvern UK Marketing Ltd V The Commissioners (1975) VATTR 52, submitted by the Appellant, stated in their determination that the facts in connection with the present case are not similar to those in the case referred to by the Appellant.

In *Wlyvern UK Marketing Ltd V The Commissioners (1975) VATTR 52*, the Wlyvern Ltd the court held:

"If this appeal is to succeed the Appellant must satisfy the tribunal that the relevant services supplied by it were not used by a person present in the United Kingdom or the Isle of Man. It is common ground that the relevant services were supplied by the Appellant to an overseas trader in each of the two instances before the tribunal. The issue is therefore limited to considering whether the supply of the relevant services to AB Skandia in the one case, and to Lindshammar Glasbruk in the other case, as evidenced by Exhibits A2 and A6 respectively, were used by a person present in the United Kingdom or the Isle of Man. It will be convenient to take each case separately.

The services supplied by the Applicant to AB Skandia Consisted of advice sent to the Swedish client. This advice is in our decision 'used' when consideration is given to its adoption or rejection. This was effected in Sweden when the advice of the Appellant was considered by the Board of Management of the Company, or the officer to whom the Company had delegated authority. Mr. MA Cooper relied on the occasional presence in the United Kingdom of Herr Metz to support his proposition that the relevant supplies were used by a person present in the United Kingdom. The tribunal does not accept that use pf supplies made to a company in Sweden was made by a person present in the United Kingdom when Herr Metz paid these visits. The purpose of the visits was not for the use of the advice, but so that Herr Metz could ascertain facts for himself and advice himself and his company as a result of his visit. The tribunal is satisfied that the supply by the Appellant to AB Skandia in Sweden of its services in the form of advice did not result in the use of such supply be a person present in the United Kingdom and the Appellant's appeal with regard to Exhibit A2 succeeds".

We are of the view that the above-mentioned case is similar to the present one, as it also deals with information provided by the Appellant outside the country. In the present case, the Appellant has provided information about the customers and their needs to the Principal, enabling them to manufacture the machines according to the customers'

specific requirements. We believe that the CGIR has incorrectly interpreted the said judgment in relation to the present case.

Therefore, in answering questions of law (iv) to (x), we hold that the Board of Review has misinterpreted the provisions and the case law. We conclude that the commission received by the Appellant is for a service consumed outside Sri Lanka.

Finally, in light of the responses provided to the above questions of law in favor of the Appellant, we allow the appeal by setting aside the determination of the CGIR dated 08/06/2006 and the determination of the Board of Review dated 12/01/2010. The Registrar is directed to send a copy of this judgment to the secretary of the TAC.

Appeal Allowed.

JUDGE OF THE COURT OF APPEAL

D.N.SAMARAKOON,J

I AGREE

JUDGE OF THE COURT OF APPEAL