

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

In the matter of an application for the issue of mandates in the nature of writ of Certiorari and a writ of Prohibition.

Oriflame Lanka (Pvt) Ltd,
74, Dharmapala Mawatha,
Colombo 7.

Petitioner

C.A (Writ) Application No. 307/2007

Vs

1. Commissioner General of Inland Revenue,
Department of Inland Revenue,
Sir Chittampalam A Gardiner
Mawatha, Colombo 2.
2. Attorney General,
Attorney General's Department,
Colombo 12.

Respondents

BEFORE : **S.SRISKANDARAJAH, J,**

COUNSEL : K.Kanag-Isvaran PC with Ms. Dilshani Wijawardana.
for the Petitioner.

Farzana Jameel DSG
for the 1st and 2nd Respondents.

Argued on : 27.08.2009, 26.10.2009, 03.12.2009 & 07.12.2010.

Written Submissions on : 26.05.2010(Petitioner),
26.05.2010 (Respondents)

Decided on : 09.05.2011

S.Sriskandarajah, J.

The Petitioner is a Company incorporated in Sri Lanka and it is engaged in the business of importing and distributing cosmetics. The Petitioner's products are not available in the traditional whole sale or retail market but its products are available with the persons identified and called as 'Beauty Consultants'. The Petitioner's net work functions when individuals join up as beauty consultant, to sell Oriflame products to the general public. The beauty consultant in addition to the selling of the Petitioner's products to the general public also encourage other individuals to join as beauty consultant to sell the Petitioner's product. Each beauty consultant is encouraged to sponsor as many other consultants as possible. The beauty consultant and those who are sponsored by the beauty consultant and those who are sponsored by the sponsored beauty consultant are all called beauty consultants and they become a distinct group. Similarly there will be several groups of this nature through which the Petitioner's products are being sold to the public.

The Petitioner publishes a monthly catalogue of all its range of products together with their selling price at which it is sold to the general public by the beauty consultants. Each beauty consultant collects their orders from the general public for the products catalogued in a particular month and places his or her order with the Petitioner. The Petitioner after the receipt of the order raises a goods delivery note with details of the products ordered

including the quantity and the price. The consultants have to pay the Petitioner to purchase the said products. The product once purchased by the beauty consultant cannot be returned. The purchase is not on a sale or return basis.

The Petitioner sells its products to the consultant at a price 30% less than the catalogue price. Each beauty consultant is also entitled to a performance discount based on the purchases of the group to which he or she belongs as well as his or her individual performance in a particular month, in respect of the Petitioner's product. The Petitioner in calculating VAT on the products sold to the beauty consultants has calculated on the basis of the consideration actually paid by the beauty consultants for the products that they purchased taking in to consideration of the 30% discount on the purchase price and the performance discounts. The Petitioner's VAT return from August 2002 to December 2004 calculated on this basis was rejected by the Commissioner General of Inland Revenue the 1st Respondent and assessments were issued by the 1st Respondent for this period. The main reason for the rejection of the said returns is that the taxable supply is under stated by the amount of sales promotion expenses which has been wrongly defined by the company as performance bonus discount.

The Petitioner in this application has sought a writ of certiorari to quash the assessment issued by the 1st Respondent on the 10th of February 2006 in respect of the months of assessments August 2002 to December 2002, January 2003 to May 2003 and January 2004 to December 2004.

The scope of VAT is that it is a tax charged on every taxable supply of goods or services, made by a registered person, who is required to account for and pay VAT in respect of all taxable supplies made by him in the course of carrying on or carrying out a taxable activity. The business of the Petitioner is a taxable activity. In fact it is the duty of the registered person such as the Petitioner to collect the tax on behalf of the tax authorities and account for

them. So the supplier of goods or services is the one who charges VAT, collects and accounts to the revenue. The burden of VAT falls only on the consumer. In the instant case the Petitioner supplies the goods to the beauty consultants on the delivery note. The consultants have to pay the Petitioner the purchase price to the said products. The product once purchased by the beauty consultant cannot be returned. The purchase is not on a sale or return basis. The VAT Act defines the supply of goods as passing of exclusive ownership of goods to another as the owner of such goods. The fact that the goods once purchased by the beauty consultants cannot be returned to the Petitioner shows that the exclusive ownership of the goods are passed from the Petitioner to the beauty consultants in this transaction. Hence there cannot be any dispute that the beauty consultants are the consumers as far as this transaction relating to the collection of VAT is concern.

The vat is charged under Section 2, Section 4 defines the time of supply, the value of the goods supplied is determined in accordance with Section 5.

Section 2 provides; Subject to the provision of this Act , a tax to be known as the Value Added Tax (hereinafter referred to as 'the tax) shall be charged-

(a) At the time of supply, on every taxable supply of goods or services, made in a taxable period, by a registered person in the course of carrying on , or carrying out, a taxable activity by such persons in Sri Lanka,

and on the value of goods such goods or services supplied, or the goods imported as the case may be, at the following rates...,

The Respondents contended, the issues that have to be considered in relation to this application are the time of supply and the value of the goods at the time of supply. The Petitioners contended that the time of supply as defined determines the time at which the exclusive ownership of the goods and the property therein passes from the supplier to the consumer (Section 4). But

Section 4 has no relevance or application of value of goods. The value of the goods supplied is determined in accordance with Section 5 of the Act. The Petitioner further contended that before the applicable rate of VAT is calculated, one must first ascertain the 'value of the taxable supply' to the consumer. In ascertaining this value the fundamental principle of VAT has to be taken into consideration namely; the taxable supply must be on the final value to the consumer (the beauty consultants).

It is undisputed that the time of supply is at the time of the raising of delivery note as it is the time at which the Petitioner delivers the goods to its beauty consultants as well as the exclusive ownership of the goods and the property therein passes from the supplier to the consumer. Under Section 2 the Value Added Tax (VAT) shall be charged at the time of supply. Then the question arises that if one has to charge the VAT at the time of supply on the rates specified in the Act based on the value of the goods could a future concession or a discount on the price be taken into consideration in calculating the VAT component?

The Respondents' contention is that there is no future concession or reduction in the value of the goods when considering the substance of the transaction. The Respondents submitted that the Petitioner is making up the price in the catalogue, actually selling to a third party through its agent the beauty consultants, but getting the third party to pay the beauty consultant for the job done by the beauty consultant for the benefit of the Petitioner. Thus the performance discount given to the beauty consultants is actually part of the open market value which is distorted by the petitioner seeking to deduct a sum from same and thus undervalue the goods sold. In the given circumstances the Respondents contended that the decision to base the assessment of VAT on the value as set out in the delivery note at the time of supply is in compliance with the law.

As discussed above that there is no merit in the submissions of the Respondents that the beauty consultants act as the agents of the Petitioner. At the time of the supply of goods on the delivery note the property of the goods passes on to the beauty consultants and these goods cannot be returned to the Petitioner if they are not sold to a third party. The basic principle of the VAT system is that, it is intended tax only the final consumer as the VAT is a tax on consumption. As I have observed that there is no dispute for the purpose of VAT the final consumers are the beauty consultants.

I will now consider whether a future concession or a post time supply discount on the price of the goods be taken into consideration in determining the value of the goods for the purpose of calculating the VAT component?

The price a beauty consultant pay for an item, at the time of purchasing it from the Petitioner is shown in the goods delivery note. It is 30% less the catalogue price of that item. At the end of each month by raising an invoice the Petitioner reconciles a beauty consultants account and refund the performance discount of the beauty consultant by cheque or by crediting the beauty consultant's bank account directly with the amount of the discount shown in the invoice. The performance discount is calculated by the Petitioner based on the performance of each beauty consultants and the group to which they belong. The 'Invoice' shows the total purchase made by the beauty consultant less the performance discount refunded at the end of each month. It is the contention of the Petitioner that the Invoice shows the true value in the hands of a beauty consultant. i.e the price paid for the goods at the time of purchasing them less performance discount refunded as at the end of each month. Therefore what in fact the Petitioner actually receives to its hand as purchase consideration,(i.e. the price) at the end of each month is in fact the total price at date of supply less performance discounts, on which amount alone(i.e. the value of the taxable supply) VAT becomes due and payable. This latter amount is in fact the consideration in money in terms of Section 5. The

Petitioner further contended that post time of supply discount should be taken into account in arriving at the consideration of a taxable supply of goods keeping in line with the 'principle of fiscal neutrality'. If not the 1st Respondent would, in fact, be collecting a tax far in excess of the actual value paid by the consumer. This will amount to a levy of penalty which is clearly illegal and it is not contended in the Act. In support of the Petitioner's contention that post time supply discount should be taken into account in considering taxable supply of goods, the Petitioner relied in the case of *Elida Gibbs Ltd v Customs and Exercise Commissioners (1996) Simons Tax cases 1387*.

In the *Elida Gibbs* case a manufacturer of toiletries sold 70% of its products to retailers and the balance to wholesalers. To promote the retail sales of its products it operated a coupon scheme. They first offered customers a price reduction at the point of sale on the production of money-off coupons which had been circulated in the magazines or newspapers. The price reduction so allowed was reimbursed by the company to the retailers. Under the second scheme the customer could obtain cash refund from the company by returning the cash back coupon which was printed on the label of the products. The company claimed that the money refunded on the coupon constituted a discount reducing the price of its goods, with the result that taxable amount should also be reduced accordingly for VAT.

It was held: In circumstances such as those in the instant case, the manufacturer, who had refunded the value of the money-off coupon to the retailer or the value of the cash-back coupon to the final consumer received on completion of the transaction, a sum corresponding to the sale price paid by the wholesalers or retailers for his goods, less the value of those coupons. It would not therefore be in conformity with the directive for the taxable amount used to calculate the VAT chargeable to the manufacturer, as a taxable person, to exceed the sum finally received by him. Consequently, the taxable amount attributed to the manufacturer as a taxable person had to be the amount

corresponding to the price at which he sold the goods to the wholesalers or retailers, less the value of those coupons. Otherwise, the tax authorities would receive by way of VAT a sum greater than that actually paid by the final consumer, at the expense of the taxable person.

This case amply demonstrate that a discount on the price of goods whatever nature irrespective of the time it is given whether at the time of purchase or at a later date it has to be deducted from the price actually paid for the purpose of calculation of VAT. This is in keeping with the principle, that the position of taxable person must be neutral. In order to ensure observation of the principle of neutrality, account should be taken, when calculating the taxable amount of VAT.

The Respondents also submitted to court that the performance discount is in fact not a discount on the price of the goods but this sum was paid as service rendered to the company by promoting the sale of the goods.

The performance discount is given on the price of the goods purchased by the beauty consultants, this is reflected in the invoice, this discount is given for the beauty consultants and their group members to buy more items of the Petitioner's product in order to promote the sale of the goods of the Petitioner company. Even in *Elida Gibbs* case (supra) the scheme of refund of part of the purchase price in cash-back coupons operates in the same fashion. The refund scheme in *Elida Gibbs* case is as follows: coupons are printed directly on the packaging of the company's products. The coupons offer a specific cash refund of part of the purchase price paid by the retail consumer to the retailer, while also acting as proof of purchase. Any consumer who is able to satisfy the conditions printed on the coupon may send it directly to the company (or its agent) for the promised payment. The conditions require the consumer to send in the cash-back coupon accompanied by two other cartons of the company's products. The refund of part of the purchase price is not given on the production of the coupon printed on the back of the package of the

product but it will be given only when the consumer annex cartons of the company's two other products. By this the company encourages the consumer to purchase the company's products in order to promote the sale of its products. The court in *Elida Gibbs* case has held that this discount should be deducted from the price of the goods in calculating VAT. The Court based its decision on the principle of neutrality. Hence the submissions of the Respondent that the performance discount is in fact not a discount on the price of the goods but this sum was paid as service rendered to the company for promoting the sale of the goods has no merit.

For the above reasons the Respondent's rejection of the VAT returns of the Petitioner for the periods August 2002 to December 2002, January 2003 to December 2003 and January 2004 to December 2004 has no basis and therefore the issue of assessment by the Respondent for the period August 2002 to December 2002(A30), January 2003 to May 2003(A35) and January 2004 to December 2004(A47) are illegal. Hence this court issues a writ of certiorari to quash the said decision to issue fresh assessments. The application of the Petitioner as prayed for in prayer (b) and (c) are allowed without cost.

Judge of the Court of Appeal