

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

In the matter of an application for a case stated for the opinion of the Court of Appeal under and in terms of section 11A of the Tax Appeals Commission Act No. 23 of 2011 (as amended)

The Commissioner General of Inland Revenue,
Department of Inland Revenue,
Sir Chittampalam A. Gardiner Mawatha,
Colombo 00200.

APPELLANT

Case No. CA/TAX/04/2016

Vs.

Tax Appeals Commission Case No.

TAC/IT/001/2015

Aitken Spence Travels Limited

305, Vauxhall Street,

Colombo 00200

RESPONDENT

Before: Janak De Silva J.

Achala Wengappuli J.

Counsel:

Chaya Sri Nammuni State Counsel for the Appellant

Dr. K. Kanag-Isvaran P.C. with Shivaan Kanag-Isvaran and Aslesha Weerasekera for the Respondent

Written Submissions tendered on:

Appellant on 20.09.2018

Respondent on 09.07.2018 and 17.09.2018

Argued on: 26.07.2018

Decided on: 13.11.2018

Janak De Silva J.

The Respondent is a limited liability company incorporated and domiciled in Sri Lanka. The principal activity of the Respondent is providing all travel related services to clients such as providing services to Foreign Tour Operators (FTO) who organize tours to tourists visiting Sri Lanka.

When the Respondent submitted their return of income for the year of assessment 2009/2010 claiming an exemption from income tax for a part of its income under section 13(dddd) of the Inland Revenue Act No. 10 of 2006 as amended (Act), the Assessor rejected the returns. The Respondent appealed to the Commissioner General of Inland Revenue (CGIR).

The CGIR in her determination dated 07.10.2014 decided that the Respondent was not entitled to claim the tax exemption, since the Respondent provides services to foreign tourists who are physically present in Sri Lanka. The Respondent appealed to the Tax Appeals Commission (TAC).

The TAC allowed the appeal of the Respondent. The TAC determined that the Respondent received their fees in foreign currency and further the services are rendered by the Respondent to the FTOs who are outside Sri Lanka and hence the services rendered by the Respondent falls within the requirements mentioned in section 13(dddd) of the Act. Aggrieved by the said determination, the CGIR requested the TAC to have a case stated for the opinion of this Court.

The TAC has referred the following questions of law for the opinion of this Court:

- (1) Has the TAC erred in interpreting section 13(dddd) of the Inland Revenue (Amendment) Act No. 09 of 2009 as the Foreign Tour Operators were the recipient of the services rendered by the Respondent Not the Foreign Tourists who were physically present in Sri Lanka?
- (2) Section 13(dddd) of IR Act: “notwithstanding the provision of paragraph (ddd) of this section, the profits and income for the period commencing from April 1, 2009 and ending on March 31, 2011 earned in foreign currency by any resident company, any resident individual or any partnership in Sri Lanka, from any service rendered in or outside Sri Lanka to any person or partnership outside Sri Lanka, if such profits and income (less such amount, if any, expended outside Sri Lanka, as is considered by the Commissioner General to be reasonable expenses) are remitted to Sri Lanka, through a Bank”.

According to Section 13(dddd) of the Act, in order to qualify for the tax exemption provided therein, the person seeking the said exemption should:

- (i) be a resident company, resident individual or any partnership in Sri Lanka.
- (ii) have rendered any service in or outside Sri Lanka.
- (iii) have rendered the service to any person or partnership outside Sri Lanka.
- (iv) and any profits and income should be in foreign currency and be remitted to Sri Lanka through a bank.
- (v) and such profit and income should be earned for the period 1st April 2009 to 31st March 2011.

It is clear upon a reading of the brief that the divergence between the parties is on (iii). The Appellant submits that the Respondent provides services to foreign tourists who are physically present in Sri Lanka whereas the Respondent submits that it supplies services only to FTOs overseas.

The Respondent states that the nature of the services provided by it are such that the FTO, in the tourist's home country, agrees to provide the service of organizing the foreign vacation of the tourist at the desired location and for this purpose enters into a legal contract with the foreign tourist to render such services for consideration. The foreign tourist pays the consideration for such services he receives from the FTO, which payment is made in the home country of the tourist.

Thereafter, in order to fulfill its contractual obligations towards the foreign tourist, the FTO would obtain the services of a local travel service provider, such as the Respondent, and enters into an agreement with the local service provider, in this case the Respondent, to fulfill its package offering to the tourist.

At the request of the FTO, the Respondent would arrange the contents of the package (e.g. hotels, providing transport services and other excursions etc.) sold by the FTO to the foreign tourist and in return the Respondent receives a fee from the FTO under and in terms of the agreement it has signed with the FTO. The said fee is received in foreign currency and constitutes the income of the Respondent. According to the Respondent, that is essentially the nature of the services provided by the Respondent.

According to this description by the Respondent, the FTO enters into a contract with the foreign tourist in terms of which the FTO is the supplier of services and the foreign tourist is the recipient of the said service. The Respondent enters into an agreement with the FTO in terms of which the Respondent provides services to the FTO overseas.

The reasons for the determination of the TAC (Determination) is not readily comprehensible. The Determination states that the services are rendered by the Respondent to the FTOs who are outside Sri Lanka (page 7 of the Determination). On the other hand, the Determination also states that all the services provided by the Respondent are to the tourists arriving in Sri Lanka on behalf of the FTO who is a person outside Sri Lanka and is a service performed on a contract (page 9 of the Determination). The TAC goes on to hold that the phrase "a person outside Sri Lanka" in section 13(dddd) of the Act would mean a person physically out of Sri Lanka at the time of the

transaction that gave rise to the payment **for the services rendered in Sri Lanka.** (emphasis added) (page 9 of the Determination).

The Respondent as well as the TAC places much emphasis on the agreement between the Respondent and the FTO and the absence of any agreement between the Respondent and the foreign tourist to establish that the services the Respondent supplied were supplied to a person outside Sri Lanka namely the FTO. However, the contractual arrangements between parties which creates private law obligations and duties are not decisive in determining the statutory question of whether a supply of services had taken place and if so between which parties.

On that issue, it is apposite to refer to *Customs and Excise Commissioners v. Reed Personnel Services Ltd.* [(1995) STC 588 at 595, (1995) BVC 222 at 229] where Laws J. stated:

“There may be cases, generally (perhaps always) where three or more parties are concerned, in which the contract’s definition (however exhaustive) of the parties private law obligations nevertheless neither caters for nor concludes the statutory questions, what supplies are made by whom to whom. Nor should this be a matter for surprise: in principle, the incidence of VAT is obviously not by definition regulated by private agreement. **Whether and to what extent the tax falls to be exacted depends, as with every tax, on the application of the taxing statute to the particular facts. Within those facts, the terms of the contracts entered into by the taxpayer may or may not be determine the right tax result. They do not necessarily do so.** They will not do so where the contract, though it tells all the parties everything that they must or must not do, does not categorise any individual party’s obligations in a way which inevitably leads to the conclusion that he makes certain defined supplies to another.”(emphasis added)

The Respondent further submits that it supplied services only to the FTO and there were no services supplied by it to the foreign tourists in Sri Lanka. According to the Respondent it was the FTO who supplied services to the foreign tourists and not the Respondent.

In *Commissioners of Customs and Excise v. Redrow Group Plc.* [(1999) 2 All ER 13; (1999) 1 WLR 408] Redrow was involved in the construction of houses for sale in the private sector. As a sales strategy Redrow had a sales incentive scheme under which it hired, instructed and monitored an estate agent to market and sell the existing houses of its prospective buyers. Redrow entered into agreements with the estate agent and prospective buyer and undertook to pay the estate agents fee and VAT if the prospective buyer ultimately purchased a house from Redrow after selling their existing house. Since the agreement stated that Redrow would not be liable to pay this fee if the prospective buyer ultimately didn't purchase a house from them, Redrow also instructed the estate agent to enter into a separate agreement with the prospective buyer to cover their liability. **The House of Lords concluded that there could be in the same transaction a supply of services to one person and a supply of different services to another person.** In that case, the prospective purchaser clearly received a service by the estate agent to help market and sell the existing home. At the same time, Redrow was also said to have a service supplied to it by the estate agents i.e. **the right to have services rendered to a third party.**

Similarly, in the instant case the FTO provided a service to the foreign tourists by organizing their tour in Sri Lanka. In order to fulfill the obligations, it undertook, the FTO received a service supplied by the Respondent to it, namely the right to have the services agreed between the FTO and the Respondent rendered to the foreign tourist in Sri Lanka. The foreign tourist in turn received these services in Sri Lanka from the Respondent. Accordingly, the Respondent in this transaction was providing two different types services, firstly to the FTO of the right to have the services agreed between the FTO and the Respondent rendered to the foreign tourist in Sri Lanka and secondly the provision of agreed services to the foreign tourist in Sri Lanka.

Section 13(dddd) of the Act encompasses situations where a resident company, resident individual or any partnership in Sri Lanka renders any service **in or outside Sri Lanka**. Hence the place where the service is supplied is not determinative of the application of the exemption therein. The decisive question is to whom was the service supplied. The exemption will apply where the service was rendered to any person or partnership outside Sri Lanka.

The Act does not define as to who “a person or partnership outside Sri Lanka”. The TAC has held that the phrase “a person outside Sri Lanka” means a person physically out of Sri Lanka at the time of the transaction that gave rise to the payment for the services rendered in Sri Lanka.

The transaction that led to the Respondent providing two different types of services, firstly to the FTO of the right to have the services agreed between the FTO and the Respondent rendered to the foreign tourist in Sri Lanka and secondly the provision of agreed services to the foreign tourist in Sri Lanka was done when the FTO and the foreign tourist were physically out of Sri Lanka. **Accordingly, any profits and income the Respondent earned from the provision of both these services fall within the scope and ambit of the exemption in section 13(dddd) of the Act.**

Accordingly, we answer the question posed to this Court as follows:

- (1) Has the TAC erred in interpreting section 13(dddd) of the Inland Revenue (Amendment) Act No. 09 of 2009 as the Foreign Tour Operators were the recipient of the services rendered by the Respondent Not the Foreign Tourists who were physically present in Sri Lanka? **Yes. The Respondent provided two different types of services firstly to the FTO of the right to have the services agreed between the FTO and the Respondent rendered to the foreign tourist in Sri Lanka and secondly the provision of agreed services to the foreign tourist in Sri Lanka.**

For the reasons aforesaid, this Court confirms the annulment of the assessment made by the TAC and dismiss this appeal with costs.

Judge of the Court of Appeal

Achala Wengappuli J.

I agree.

Judge of the Court of Appeal