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

In the matter of an appeal by way of a Case Stated on a question of law 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).

Gold Coin Feed Mills (Lanka) Ltd,
205, Vystwyke Road,
Colombo 15.

APPELLANT

CA No. CA/TAX/001/2014
Tax Appeals Commission
No. TAC/VAT/010/2012

v.

The Commissioner General of Inland Revenue,
Department of Inland Revenue,
Sir Chittampalam A, Gardiner Mawatha,
Colombo 2.

RESPONDENT

BEFORE	:	Dr. Ruwan Fernando J. & M. Sampath K. B. Wijeratne J.
COUNSEL	:	Faisz Musthapha, PC with Riad Ameen & Rushitha Rodrigo for the Appellant. Chaya Sri Nammuni, SSC for the Respondent.
WRITTEN SUBMISSIONS	:	13.11.2018 & 07.10.2021 (by the Appellant)

		30.11.2018 & 04.10.2021 (by the Respondent)
ARGUED ON	:	04.08.2021 & 06.08.2021
DECIDED ON	:	22.10.2021

M. Sampath K. B. Wijeratne J.

Introduction

The Appellant, Gold Coin Feed Mills (Lanka) Ltd. is a company incorporated in Sri Lanka, engaged in the business of manufacturing and selling livestock feed. The Appellant submitted its monthly Value Added Tax (hereinafter referred to as 'VAT') returns for the period of 1st January 2008 to 31st December 2008, and those returns were rejected by the Assessor on the ground that the volume/contingent discounts given to customers at the end of each month, based on the volume of purchases, were not deductible in the computation of VAT under VAT Act No. 14 of 2002, as amended (hereinafter referred to as 'the VAT Act').

Accordingly, the Assessor made an additional assessment in terms of Section 31 of the VAT Act and issued an intimation letter under Section 29 of the Act. Accordingly, the balance VAT payable was Rs. 9,766,684/- (*vide* annexure 1 to the letter of intimation dated 23rd April 2010). The parties have agreed that the Appellant received a notice of assessment thereafter. The Appellant appealed to the Commissioner General of Inland Revenue (hereinafter referred to as 'the CGIR') against the said assessment. The CGIR, in his determination dated 28th August 2012, confirmed the additional assessments made by the Assessor and notice was given to the Appellant on 29thAugust 2012, in accordance with Section 34 (12) of the VAT Act.

Thereafter, the Appellant appealed to the Tax Appeals Commission (hereinafter referred to as 'the TAC') in terms of Section 7 of the TAC Act No. 23 of 2011, as amended (hereinafter referred to as 'the TAC Act'). Accordingly, the CGIR communicated the reasons for his determination to

the TAC and to the Appellant, in terms of Section 7 (3) of the TAC Act. The TAC, by its determination dated 10th December 2013, affirmed the determination of the CGIR and confirmed the assessment.

The Appellant, being aggrieved by the said decision, moved the TAC to state a case on twenty-one questions of law for the opinion of this Court, in accordance with Section 11A of the TAC Act.

The aforementioned questions of law are as follows:

1) *Does the stipulation in Section 5 (1) (a) of the VAT Act that the value of supply is the "consideration less any tax chargeable under this Act which amount shall not be less than the open market value" contemplate a comparison of the consideration received by a taxpayer with the supply of another person that fulfils the definition of "open market value"?*

2) *Did the Commission misdirect itself in law at page 6 of the determination in concluding that customers take "independent decisions" to purchase livestock feeds "based on the 'price lists' published by the Appellant Company" without any evidence before the Commission in support of such conclusions?*

3) *Did the Commission misdirect itself in law by concluding at page 7 of the determination that there is a* (sic) *"'open market price' commonly applicable to all customers on that particular day" in complete contradiction to its own finding in the preceding page 6 that "open market price of any commodity may vary" even on an "hourly" basis (in addition to varying daily, weekly etc.)?*

4) *Did the Commission misdirect itself in law by concluding at page 7 of the determination that the price was "originally charged in respect of all customers without making any differentiation" and by concluding at page 8 that such value was "commonly applicable to all the customers" in contradiction of its own findings at pages 2 and 3 of the determination that at the time of the sale trade discounts that "varied from 4% to 8% depending on the terms of payment, i.e. depending on whether purchasers* (sic) *are made on credit or cash basis, and the loyalty of the customers" were allowed to customers?*

5) *Did the Commission misdirect itself in law by contradicting itself in permitting trade discounts, which had varying rates from 4% to 8%, in determining the "open market value", but disregarding contingent/volume discounts on the basis that there is differentiation in the rates charged?*

6) *Is the differentiation in the rates charged for contingent/volume discounts based on the volume purchased by customers compatible with the definition of "open market value" in view of the stipulation in the definition that it must relate to "similar circumstances"?*

7) *Did the Commission misdirect itself in law in forming a conclusion at page 8 of the determination regarding the basis on which the wholesale customers of the Appellant would make their sales in the absence of any evidence to support such conclusion?*

8) *In any event, does the basis on which the Appellant's wholesale customers made their sales have any relevance to the ingredients of the definition of "open market value" in relation to supplies made by the Appellant to such wholesale customers?*

9) *Did the Commission misdirect itself in law in failing to apply or consider the interpretation of Section 25 (1) of the VAT Act by the Department of Inland Revenue itself in the "Manual of Value Added Tax Law (Revised Edition – 2007)"?*

10) *Is Section 25 (1) of the VAT Act inapplicable in adjusting the amount of tax overcharged or undercharged due to occurrence of events subsequent to the issuance of a tax invoice?*

11) *Does Section 25 (1) of the VAT Act require a separate credit note for each tax invoice?*

12) *Is a single tax credit note in respect of all invoices issued to a customer for a particular taxable period contrary to the requirements of Section 25 (1) of the VAT Act?*

13) *If so, is such requirement in Section 25 (1) of the VAT Act mandatory or directory?*

14) Does a discount have to be made "on the basis of the price of the product" for the purpose of applicability of Section 25 (1) of the VAT Act?

15) Has the Commission failed to appreciate that not allowing input credit to the Appellant on the basis of tax credit notes issued by it to its customers, where the Commissioner General of Inland Revenue would be collecting output tax of an equal amount from the recipients of such credit notes, under Section 25 (2) (b) of the VAT Act, would confer undue additional revenue to the Department of Inland Revenue?

16) Did the Commission misdirect itself in law at page 11 concluding that a discount based on the volume of the supply is "similar to an incentive payment" in the absence of any legal basis to equate a discount as being similar to an incentive payment?

17) Did the Commission misdirect itself at page 11 of the determination in concluding that a "'volume discount' is not a discount freely offered and made among persons" in the absence of any evidence in support of such conclusion?

18) Did the Commission misdirected (sic) *itself in law in failing to reduce or annul the amount payable as penalty in terms of Section 27 (1) of the VAT Act in view of the accumulated input tax credit that was due to the Appellant from the Department of Inland Revenue?*

19) Has the Commission misdirected itself in law in failing to appreciate that the Commissioner General of Inland Revenue ought to have reduced the penalty in terms of the proviso to Section 27 (1) of the VAT Act in view of the accumulated input tax credit that was due to the Appellant from the Department of Inland Revenue?

20) Has the Commission failed to appreciate that the similar revenue neutral adjustments are made in the VAT payable calculations under the VAT Act, on account of "bad debts" incurred, under Section 24 of the VAT Act, and in relation to "sales returns" received by the supplier, disregarding the concept of "open market value"?

21) Has the Commission misdirected itself in law in determining that the VAT in dispute in this case is only the balance tax payable amounting to Rs. 9,766,684/- when the Assessor has assessed an additional VAT liability of Rs. 65,111,240/- and the Commissioner General of Inland Revenue has confirmed it?

Briefly, the facts relevant to the instant appeal are as follows:

As stated above, the Appellant is engaged in the manufacture of livestock feed. The Appellant's products were sold only to authorized customers, who were about 60 in number, based on price lists announced by the company. At the time of sale, trade discounts ranging from 4% to 8% were given to customers, depending on whether the purchases were made on credit or cash, and based on the loyalty of the customer. 'Sales invoices' were issued accordingly; with all of them being 'tax invoices' for the purposes of the VAT Act, as all of the Appellant's customers were VAT-registered.

In addition to the aforesaid trade discounts, the Appellant gave a contingent/volume discount ranging from 1% to 10% to its customers at the end of the month, depending on the volume of goods purchased within that month by each customer. It is crucial to note at this stage that the precise value of these volume discounts could not be included on the invoices issued at the time of sale, as the said value was only determined at the end of each month after taking all purchases made during that particular month into account. Accordingly, 'tax credit notes' were issued to each customer, covering tax invoices issued during the relevant month to a given customer (*vide* the two annexures marked 'A3' tendered along with the written submissions of the Appellant to the TAC).

The particulars to be included in a tax invoice are specified in Section 20 (2) of the VAT Act. The format for tax credit notes has been suggested by the Department of Inland Revenue (hereinafter referred to as 'the DIR'), in the Manual of Value Added Tax Law (Revised Edition – 2007) (hereinafter referred to as 'the 2007 VAT Manual').

The Appellant has submitted that issuing tax credit notes did not result in any change to the nett tax payable by both the Appellant and its VAT registered customers since the reduction of tax collected by the Appellant,

set out in the tax credit note, would be offset by the increase in the VAT payable by its VAT-registered customers at the next step of the VAT chain.

According to the Appellant, the actual consideration it receives for the supply of livestock feed is the nett amount once both trade discounts and volume discounts have been applied. As such, the Appellant submitted its VAT returns based on the actual consideration received after accounting for both discounts.

The Respondent's contention is that the Appellant should not be allowed to adjust the value of a taxable supply, for the purpose of calculating VAT, owing to a contingent/volume discount granted to its customers subsequent to the time of supply. In other words, the Respondent has submitted that the adjustment of VAT owing to post-sale discounts is not allowable under the provisions of the VAT Act.

I will now move on to consider the questions of law set out above in this judgment. In considering these questions, whether they make specific reference to the facts of the case or otherwise, it is obvious that the Court would have to scrutinise the facts so far as they are relevant to a given question of law, unless a question involves a matter of pure interpretation.

It is trite law that the consideration of whether the available facts are sufficient to arrive at a conclusion constitutes a question of law.[1]

In the volume titled *Income Tax In Sri Lanka*, Gooneratne states that:[2]

'The principle is well established that where a tribunal arrives at a finding which is not supported by evidence the finding though stated in the form of a finding of fact is a finding which involves a question of law. The question of law is whether there was evidence to support the finding, apart from the adequacy of the evidence. The Court will interfere if the finding has been reached without any evidence or upon a view of facts which could not be reasonably entertained. The evidence can be examined to see whether the Board [being the Board of Review; the predecessor to the TAC] *being properly appraised of what they had to do could reasonably have arrived at the conclusion they did.'*

[1] *D. S. Mahawithana v. Commissioner of Inland Revenue*, 64 N.L.R. 217

[2] M. Weerasooriya and E. Gooneratne, *Income Tax In Sri Lanka*, Second Edition, 2009. at p.452 [citing *Stanley v. Gramophone & Typewriter Co. Ltd.* 5 TC 358; *CIR v. Samson* 8 TC 20; *Cape Brandy Syndicate v. CIR* 12 TC 358; *Mills v. John* 14 TC 769; *Cooper v. Stubbs* 10 TC 29; *J. G. Ingram and Son Ltd. v. Callaghan* 45 TC 151]

These primary and secondary sources of law make it plain that this Court can indeed scrutinise the facts of a case in formulating its opinion on a stated case.

Since the first, fifth, sixth, tenth, fifteenth, and twentieth questions of law are inter-related, I will consider them simultaneously. The tenth question of law will be considered again when answering the ninth question of law.

1. ***Does the stipulation in Section 5 (1) (a) of the VAT Act that the value of supply is the "consideration less any tax chargeable under this Act which amount shall not be less than the open market value" contemplate a comparison of the consideration received by a taxpayer with the supply of another person that fulfils the definition of "open market value"?***

5. ***Did the Commission misdirect itself in law by contradicting itself in permitting trade discounts, which had varying rates from 4% to 8%, in determining the "open market value", but disregarding contingent/volume discounts on the basis that there is differentiation in the rates charged?***

6. ***Is the differentiation in the rates charged for contingent/volume discounts based on the volume purchased by customers compatible with the definition of "open market value" in view of the stipulation in the definition that it must relate to "similar circumstances"?***

10. ***Is Section 25(1) of the VAT Act inapplicable in adjusting the amount of tax overcharged or undercharged due to occurrence of events subsequent to the issuance of a tax invoice?***

15. ***Has the Commission failed to appreciate that not allowing input credit to the Appellant on the basis of tax credit notes issued by it to its customers, where the Commissioner General of Inland Revenue would be collecting output tax of an equal amount from the recipients of such credit notes, under Section 25(2) (b) of the VAT Act, would confer undue additional revenue to the Department of Inland Revenue?***

20. ***Has the Commission failed to appreciate that the similar revenue neutral adjustments are made in the VAT payable calculations under the VAT Act, on account of "bad debts" incurred, under Section 24 of the VAT***

Act, and in relation to "sales returns" received by the supplier, disregarding the concept of "open market value"?

The Appellant contended that Section 25 (1) of the VAT Act permits the issue of a tax credit note where a registered person has issued a tax invoice and accounted for an incorrect amount of tax by over-charging the customer.

The Respondent, relying on Sections 2 (1) (a), 4 (1) (a), 5, and 23 of the VAT Act, has argued that volume discounts cannot be deducted from the taxable supply and submitted that the taxable value in the invoice should be the price, less only the trade discount. Further, it has been submitted that the "open market value" defined in Section 83, read along with Section 5 of the VAT Act, disallows the deduction of volume discounts. For clarity, I will reproduce the aforementioned Sections below.

The 'time of supply of goods' is defined in Section 4 of the Act, which reads as follows:

> ***4.*** *(1) The supply of goods shall be deemed to have taken place at the time of the occurrence of any one 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.*
>
> *(2) (...)*

On the facts of this case, the taxable supply has taken place at the time an invoice is issued to a customer. The learned Senior State Counsel has contended in her written submissions (para. 95) that the Appellant's stance is that the time of supply is not when invoices are issued, but when payment is made. This Court observes that there was no such argument by the Appellant, as Section 4 (1) (a) applies clearly.

According to Section 5 (1) of the Act, the value of a taxable supply of goods or services shall be such amount where the supply is:

(a) For a consideration in money, be such consideration less any tax chargeable under the Act which amount shall not be less than the open market value:

(b) (...)

'Open Market Value' is defined in Section 83 of the Act as follows:

> ***83.*** ***"open market value"*** *in relation to the value of a supply of goods or services at any date means, the consideration in money less any tax charged under this Act, which a similar supply would generally fetch if supplied in similar circumstances at that date in Sri Lanka, being a supply freely offered and made between persons who are not associated persons.*

In the instant case, the consideration paid by the customer to the supplier was adjusted at the end of the month according to the volume discount granted, and VAT was determined on the adjusted value of the supply.

The argument of the learned Counsel for the Appellant is that Section 25 of the VAT Act which read thus, provides for such an alteration;

> ***25.*** *(1) Where a registered person, has issued a tax invoice and accounted for an incorrect amount of tax by undercharging or overcharging tax on a supply made to another person, he shall be entitled to issue to such other person a tax debit note or a tax credit note, as the case may be, for the purpose of adjusting the amount of tax so undercharged or overcharged.*
>
> *Provided, however, the adjustment in respect of input tax under claimed on an original tax invoice shall be made in respect of a tax debit note or a tax credit note issued not later than six months after the issue of the original tax invoice, to which the tax debit note or the tax credit note relates.*
>
> *(2) Upon the issue of the tax debit note or tax credit note, as the case may be, in respect of a supply and in relation to the period in which such note was issued –*
>
> *(a) the supplier shall pay as output tax such amount of the tax that was chargeable in respect of the supply as*

in excess of the amount that was accounted for or deduct as input tax such amount as was accounted for as output tax as exceeds the amount of tax chargeable; and

(b) the person to whom the supply was made shall if such person is a registered person pay as output tax such amount of the tax that was deducted by him as input tax as exceeds the proper amount that should have been deducted or deduct as input tax such amount as was deductible as exceeds the actual amount deducted by him, as the case may be.

(3) The tax debit note or tax credit note referred to in subsection (1) shall be in the specified form.

At the argument, the learned Counsel for the Appellant relied on the Sri Lankan authority, *Oriflame Lanka (Pvt) Ltd. v. The Commissioner General of Inland Revenue and Another* (hereinafter referred to as '*Oriflame*'),[3] wherein this Court had allowed adjustments for initial discounts on the purchase price as well as subsequent performance-based discounts, for the purpose of calculation of VAT.

In the above aforementioned case, His Lordship Sriskandarajah J. cited *Elida Gibbs Ltd v. Commissioners of Customs and Excise* (hereinafter referred to as '*Elida Gibbs*'),[4] wherein the Court of Justice of the European Communities (Sixth Chamber) observed that:

"*The basic principle of the VAT system is that it is intended to tax only the final consumer. Consequently, the taxable amount serving as a basis for the VAT to be collected by the tax authorities cannot exceed the consideration actually paid by the final consumer which is the basis for calculating the VAT ultimately borne by him.*".[5]

Elida Gibbs Ltd. was a manufacturer of toiletries and 70% of its products were sold to retailers and the balance to wholesalers. To encourage retail sales, the company implemented two coupon schemes. They first offered a

[3] CA (Writ) Application No. 307/2007, decided on 09.05.2011

[4] Case C-317/94; [1996] STC 1387 [The principle set out in *Elida Gibbs* was subsequently applied in the cases of *Freemans plc v. Commissioners of Customs and Excise* (Case C-86/99) and *The Littlewoods Organisation Plc v. Commissioners of Customs and Excise* ([2001] EWCA Civ 1542)]

[5] *Ibid*. at para. 19

price reduction at the point of sale, for the production of money-off coupons circulated in magazines or newspapers. The said price reduction was reimbursed to the retailers. Under the second scheme, the consumer could obtain a cash refund from the company by returning the cashback coupons printed on the label of the product.

Elida Gibbs Ltd. claimed that the sums refunded on coupons constituted a discount and therefore, VAT had to be charged on the value once adjusted for these coupons.

The Court therefore observed that:[6]

"*In circumstances such as those in the main proceedings, the manufacturer, who has refunded the value of the money-off coupon to the retailer or the value of the cashback coupon to the final consumer, receives, 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* (sic) *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.* ***Were that the case, the principle of neutrality of VAT vis-à-vis taxable persons, of whom the manufacturer is one, would not be complied with****.*

Consequently, the taxable amount attributable to the manufacturer as a taxable person must be the amount corresponding to the price at which he sold the goods to the wholesalers or retailers, less the value of those coupons (emphasis added)."

It was further observed that:[7]

"*…in order to ensure observance of* ***the principle of neutrality****, account had to be taken, when calculating the taxable amount for VAT, of situations where a taxable person who, having no contractual relationship with the final consumer but being the first link in a chain of transactions which ended with the final consumer, granted the consumer the reduction through retailers or by direct repayment of the value of the coupons* (emphasis added)."

[6] *Supra* note 4, at para. 28, 29

[7] *Ibid.* at para. 31

The principle as decided by the Court of Justice of the European Communities, that where a trader supplies goods for a stated consideration, but under a sales promotion arrangement was obliged to pay an amount away to the ultimate consumer or to an intermediary in the chain of supply, the consideration on which the trader should finally be liable to VAT was to be reduced by the amount so paid away, is applicable to the instant case. It is true that what was paid out was in the form of a coupon rather than money, but that did not change the result in *Elida Gibbs*.

Under the principle of neutrality, a trader should not be charged VAT on an amount greater than the true proceeds to him of the supply transaction, or an amount greater than the true cost of the supply to the ultimate customer. If the terms of the supply provide for circumstances where the trader, having received a consideration for it in the first instance, was later obliged to part with an amount related in some way to the supply transaction, the true proceeds of the supply must be determined after taking account of what the trader had to part with.

It must be noted that unlike the laws applicable to *Elida Gibbs* (where Article 11 (A) (1) (a) read with Article 11 (C) (1) of Directive 77/388/EEC of the Council of the European Communities makes express provision for the reduction of the taxable value of supply, after the time of supply), the Sri Lankan VAT Act does not make such express provision. However, the principle of neutrality has general applicability, and has been given effect by this very Court through the aforementioned judgement of His Lordship Sriskandarajah J. in *Oriflame*.

The facts of *Oriflame*, in so far as they are relevant to the present appeal, are as follows. Oriflame products were not sold on the wholesale or retail market. Those products could only be purchased from persons identified as 'beauty consultants'. They collected orders from their customers and placed their order with Oriflame each month. Oriflame sold its products to these beauty consultants at a price 30% below the catalogue price, constituting the first discount (comparable to the trade discount in the instant appeal). Other than this discount granted at the time of sale, the beauty consultants were also given a performance discount based on the quantity of purchases made in a particular month, which constituted the second discount. An important distinction to be made with the instant appeal is that Oriflame issued invoices only when *both* applicable discounts had been determined.

Oriflame calculated VAT on the actual consideration paid by the beauty consultants, after deducting the 30% discount on the purchase price as well as the performance discount, and tendered their VAT returns accordingly. The CGIR rejected the returns and issued assessments on the basis that the taxable supply had been understated by misrepresenting sales promotion expenses as performance discounts.

His Lordship Sriskandarajah, J. held that only what Oriflame actually received as purchase consideration (after both types of discounts were allowed where applicable) at the end of each month was to be considered the price at the time of supply; the value of the supply on which VAT was payable.

Though fiscal statutes generally require strict interpretation, N. S. Bindra states that:[8]

'*The principle that fiscal statutes should be strictly construed does not rule out the application of the principles of reasonable construction to give effect to the purposes or intention of any particular provision as apparent from the scheme of the Act, with the assistance of such external aids as are permissible under the law.*'

Therefore, the principle of neutrality as invoked in *Oriflame* can be applied in the instant case through a combined reading of Section 4 (1) (a), Section 5 (1) (a), Section 25, other relevant sections of the VAT Act, as well as the 2007 VAT Manual. The procedural aspects of Section 25 come under separate questions of law.

I therefore hold that the value of a supply of goods as defined through the various provisions of the VAT Act can accommodate post-sale quantity discounts such as those in issue in the instant appeal, without being contrary to the meaning of the 'time of supply' as specified in Section 4 of the Act, so long as the terms of any such discount are known to any and all potential customers at the actual time of supply, and those terms are equally honoured in the calculation of any applicable discounts.

The learned Senior State Counsel has submitted (para. 61 f.) in her written submissions that the State stands to lose revenue where tax adjustments are allowed through the use of tax credit notes, if the recipients of these credit notes are dishonest in calculating their input tax. This potential for

[8] N. S. Bindra, *Interpretation of Statutes*, Eighth Edition, 1997. at pp.674-675

dishonesty will be addressed under the eleventh, twelfth and thirteenth questions of law.

Upon carefully considering the relevant calculation itself, my opinion is that taking the actual value of supply after allowing for the deduction of any post-sale discounts to be the taxable value of supply, causes no loss to the State and does not overcharge the taxpayer. In fact, the learned Senior State Counsel has conceded this (para. 81) in her written submissions. In order to illustrate this better, I now reproduce the model which this Court formulated in the case of *The Commissioner General of Inland Revenue v. Rhino Roofing Products Limited*:[9]

"In a transaction such as the one in the instant case, and where each step follows the other temporally:

> *(a) a certain amount is paid for a supply of goods, at the time of said supply (this is the initial value of supply);*
>
> *(b) tax is calculated on the value of supply in (a), and remitted to the IRD;*
>
> *(c) a post-sale quantity discount is offered on the supply of goods, and the value in (a) is adjusted to a lower value (this lower value is now the actual value of supply); and*
>
> *(d) tax is calculated on the adjusted value of supply in (c),*

the actual value of the supply would now be the adjusted value in (c).

In the context of an adjustment arising out of a discount, it should be apparent that the adjusted value of supply in (c) is less than the initial value of supply in (a). It should also be apparent that (d), i.e. the amount of tax calculated on the adjusted value of supply, is less than (b), i.e. the amount of tax calculated on the initial value of supply. The customer will have to be reimbursed the amounts of ***1)*** *(a) - (c) (the quantity discount), and* ***2)*** *(b) - (d) (the amount of tax overcharged). The IRD would be in possession of the tax amount (b), when it should only be in possession of the tax amount (d), since the actual value of supply is (c), not (a). Therefore, the supplier is at a loss, i.e. the amount (b) - (d). The supplier will in effect have collected and remitted the correct tax amount (d), as well as some extra tax amount (b) - (d) to the IRD. Therefore, in the final analysis, the supplier*

[9] CA (TAX) 07/2019, decided on 20.07.2021, at pp.13-14

would have been overcharged and the principle of neutrality violated. The IRD would therefore have to allow for the extra amount it has received, i.e. (b) - (d) to be credited back to the supplier, in this case, the Respondent.

What appears to happen in the learned Deputy Solicitor General's calculations is that the State mysteriously 'loses' some amount (b) - (d), though in actuality, this is merely an illusion, since the State ought not to have been in possession of that amount in the final analysis, once the adjustment is allowed according to the principle of neutrality.

It should therefore become clear that there is no loss incurred upon the State if post-sale adjustments are made to the taxable value of supply. Lending further support to this conclusion is the fact that the Legislature has in its wisdom allowed for the counter proposition where the CGIR on the face of it 'benefits' from an adjustment, where tax is undercharged on a supply, and must subsequently be adjusted by way of debit notes (see Section 25 in general)."

As regards the interpretation of the 'open market value' in the instant case, the learned Senior State Counsel has submitted on behalf of the Respondent that the concept of 'open market value' would stand to be violated if the variation in the discounts were allowed to stand. In the present case, some dealers were eligible for the full 10% quantity discount, while some were eligible for a value between 1% and 10%, depending on the quantities purchased from the Appellant. It is unclear whether some dealers did not even get the benefit of the 1% discount, but that is not of crucial importance for the purposes of this appeal.

In my view, the definition of the open market value would be met where the discount is available to all those who satisfy the terms of the discount, without any discrimination. The Section 83 definition of the open market value does not appear to be breached by the practices of the Appellant, since a similar supply would generally be eligible for the same discount. The only contention may be that the discounts are determined post-sale, but this condition, in my view, falls within the 'similar circumstances' mentioned in the definition under Section 83. The crucial factor is that the availability of the discount, its terms, and how the varying percentages are assigned, must be known to all customers of the Appellant at the time of supply, which appears to be the case on the facts before this Court.

Having considered the above, I answer the first, fifth, sixth, fifteenth, and twentieth questions of law in the affirmative, noting that in the case of the fifth question of law, it was the Assessor that allowed the trade discounts, which were not in issue before the TAC. I answer the tenth question of law in the negative, with the qualification that in the case of adjustments arising from post-sale discounts (which is the subject matter of this appeal), any such adjustments may only be done in accordance with terms known to all customers at the point of sale, so as not to be contrary to the concept of an open market value.

2. ***Did the Commission misdirect itself in law at page 6 of the determination in concluding that customers take "independent decisions" to purchase livestock feeds "based on the 'price lists' published by the Appellant Company" without any evidence before the Commission in support of such conclusions?***

   The prices of the Appellant's products were published and were subject to change without prior notice (*vide* eighteen price lists marked as "A2"). On a perusal of these price lists, it appears that the prices have regularly changed monthly and sometimes within the month itself. Hence, it is obvious that the customers would have made their purchases based on self-made decisions.

   I cannot therefore hold that the TAC had misdirected itself in law in arriving at this particular conclusion. I therefore answer the second question of law in the negative.

3. ***Did the Commission misdirect itself in law by concluding at page 7 of the determination that there is a* (sic) *"'open market price' commonly applicable to all customers on that particular day" in complete contradiction to its own finding in the preceding page 6 that "open market price of any commodity may vary" even on an "hourly" basis (in addition to varying daily, weekly etc.)?***

   The 'open market value' is not an abstract concept, within its definition in the VAT Act. Admittedly, discounts may vary within the percentage range, depending on the volume of goods purchased within the month (*vide* page 1 of reasons for the determination of the CGIR marked 'X3'). The open market value applicable to the instant appeal is a value that contemplates the application of the full volume discount, as the terms of this discount are known to all customers at the point of sale. Section 5 (1) (a) of the VAT

Act allows the consideration for a supply to be *more than* the open market value, thus being compatible with any discount rates less than the full 10%. However, the open market value is a fixed amount for those customers who make the same volume of purchases (thus constituting 'similar circumstances') and therefore become entitled to the same percentage of discount. This reasoning holds true for the trade discounts as well, which have been allowed by the Assessor and confirmed by the CGIR and the TAC.

Therefore, the TAC was correct in its conclusion at page 7 of its determination that there is an open market price commonly applicable to all customers on a particular day (allowing for 'similar circumstances'), although I am of the view that, as reasoned above, this conclusion does not disallow volume discounts from being awarded and tax adjustments from being made accordingly, following the time of supply. However, I hold that the TAC was incorrect in its finding at page 6 of its determination that the open market value may vary even on an hourly basis. Such a variation does not appear to fit within the Section 83 definition of 'open market value' found in the VAT Act, which clearly enacts a daily standard.

In answering the third question of law, I am of the view that the TAC had merely contradicted itself, but had ultimately not misdirected itself in law on this particular question, as its conclusion on page 7 is correct. I therefore answer the third question of law in the negative.

4. ***Did the Commission misdirect itself in law by concluding at page 7 of the determination that the price was "originally charged in respect of all customers without making any differentiation" and by concluding at page 8 that such value was "commonly applicable to all the customers" in contradiction of its own findings at pages 2 and 3 of the determination that at the time of the sale trade discounts that "varied from 4% to 8% depending on the terms of payment, i.e. depending on whether purchasers*** **(sic)** ***are made on credit or cash basis, and the loyalty of the customers" were allowed to customers?***

   The TAC has observed at page 7 of its determination that when volume discounts are calculated at the end of the month, the open market price originally charged in respect of all customers *without any differentiation* would result in different rates, from customer to customer. Subsequently, at page 8 of its determination, it has observed that the open market value

at a particular date is certain in all respects, commonly applicable to all the customers.

It is an undisputed fact that the Appellant, at the time of sale, offered trade discounts to its customers varying from 4% to 8%. These initial discounts were allowed by the Assessor and confirmed by the CGIR, and their legality has not been contested. Therefore, it is clear that the amount charged at that time of sale also varies from customer to customer.

The learned Senior State Counsel has submitted (para. 96) that it is undisputed that VAT is calculated after trade discounts are given. She has then advocated (para. 102 f.) that the open market value applicable to a supply by the Appellant ought to be defined as that which is contained in the original price list published by the Appellant, as this is the only definition acceptable under Section 83 of the VAT Act (para. 128). When considering Section 5 (1) (a) of the VAT Act, these two submissions on behalf of the Respondent are contradictory, since the consideration received for a supply of goods cannot be less than the open market value. However, since trade discounts have been allowed, the consideration received (at the time of supply) is indeed less than the prices listed, thus making it less than the proposed open market value, which would make it contrary to Section 5 (1) (a).

Therefore, since trade discounts have been allowed at all preceding stages of this appeal, and since they have been endorsed by the learned Senior State Counsel herself, her submission that the list price should be counted as the open market value cannot be accepted. In keeping with this theme, the submission on behalf of the Respondent (para. 109) that one particular open market value cannot be achieved if the variability in the volume discounts is allowed to stand, must also be rejected, since on that ground, the allowance of trade discounts too results in the same variability. In fact, the Senior State Counsel herself has conceded (para. 147) that the 'loyalty' the Appellant relies on to give a certain percentage of trade discount introduces an element of variability.

The Appellant has submitted that the open market value is a property that must be determined based on a comparison between two separate supplies made on the same day, and (paras. 42-48) that there was no evidence before either the CGIR or the TAC that could have been used to determine such a value. I am willing to accept this submission of the Appellant.

In concluding my analysis of this question of law, I must express some doubt as to whether the 'loyalty' consideration the Appellant has used in calculating its trade discounts can be justified under the Section 83 definition of open market value, as its fit under the phrase 'similar circumstances' seems questionable. Nevertheless, the Assessor has allowed trade discounts in all their separate forms, and this Court need not scrutinise them as they are not in issue in the instant appeal, particularly since the learned Senior State Counsel has also conceded their legality.

Hence, I am of the view that the TAC has misdirected itself on the above facts and I therefore answer the fourth question of law in the affirmative.

7. ***Did the Commission misdirect itself in law in forming a conclusion at page 8 of the determination regarding the basis on which the wholesale customers of the Appellant would make their sales in the absence of any evidence to support such conclusion?***

8. ***In any event, does the basis on which the Appellant's wholesale customers made their sales have any relevance to the ingredients of the definition of "open market value" in relation to supplies made by the Appellant to such wholesale customers?***

I do agree with the learned Counsel for the Appellant that the TAC's assumption, that the wholesale customers of the Appellant would make their sales to their retailers or ultimate users based on the price at which they made their purchases, is not supported by any evidence.

The learned Senior State Counsel has submitted (paras. 81-87) that if the final customer does not get the benefit of the reduction in VAT that results from the volume discounts granted by the Appellant, then he stands to pay a higher value of VAT than that which has been charged for the value of supply. She has submitted (para. 87) that in the case of *Oriflame*, it was the beauty consultants who were the ultimate beneficiaries of the reduction in VAT, and not the final consumer. While it is needless to say that there is no evidence on the latter point, it is indeed correct that the reduction in VAT must be reflected at all subsequent stages of the VAT chain, and the end consumer must only pay such an amount of VAT as is remitted to the State. This was specified in unambiguous terms in *Elida Gibbs*,[10] and is a necessary condition for the principle of fiscal neutrality to be upheld.

[10] *Supra* note 7

However, there is no evidence before this Court (nor was any such evidence lead before either the CGIR or the TAC) to establish that such a benefit was not granted to the final consumer. It is the role of the Assessors to pursue this reduction in VAT at subsequent stages of the VAT chain, and to bring to the attention of the DIR any irregularities that arise due to any parties not adjusting their VAT liability in order to reflect the initial reduction. This Court cannot deny the Appellant its VAT credit merely because certain parties may abuse the process at subsequent stages of its VAT chain.

Since the matter in issue concerns the adjustment of input and output taxes of the Appellant and its immediate customers, the basis on which the Appellant's customers made their sales have no relevance to the open market value of the particular transaction.

I therefore answer the seventh question of law in the affirmative and the eighth question of law in the negative.

9. ***Did the Commission misdirect itself in law in failing to apply or consider the interpretation of Section 25(1) of the VAT Act by the Department of Inland Revenue itself in the "Manual of Value Added Tax Law (Revised Edition – 2007)"?***

10. ***Is Section 25(1) of the VAT Act inapplicable in adjusting the amount of tax overcharged or undercharged due to occurrence of events subsequent to the issuance of a tax invoice?***

During his oral submissions, the learned Counsel for the Appellant produced an excerpt from the New Zealand Goods and Services Tax Guide (Goods and Services Tax Legislation - 3rd Edition), where the guidelines for the implementation of Section 25 (1) of the Goods and Services Tax Act No. 141 of 1985, as amended, (hereinafter referred to as 'the New Zealand GST Act') are set out. Section 25 (1) (a), (aa), (ab), (b), (bb), and (c) of the New Zealand GST Act specifically set out the instances where it is considered that the amount of tax stated in a tax invoice in relation to a supply is *incorrect* under Section 25 (1) (d).

The particular part of the Section reads as follows:

(a) that supply of goods and services has been cancelled; or

(aa) the nature of that supply of goods and services has been fundamentally varied or altered; or

(aab) [Repealed]

(ab) the supplier—

(i) incorrectly applied this Act to the treatment of the supply, so that the supply was charged with tax at an incorrect rate, or charged with tax when it should not have been, or not charged with tax when it should have been; and

(ii) did not subsequently make an election under section 24(5B) for the supply; or

(abb) [Repealed]

(b) the previously agreed consideration for that supply of goods and services has been altered (except as provided in subsection (1B)),[11] ***whether due to the offer of a discount or otherwise*** (emphasis added)*; or*

(bb) the supply of goods is treated as being a supply of distantly taxable goods that is made in New Zealand and charged with tax at a rate of more than zero, and—

(i) the supplier receives a declaration from the recipient, or other confirmation, that the amount of tax charged under section 12 on the importation into New Zealand of the goods was paid when the goods were imported; and

(ii) the supplier reimburses the recipient for the amount of tax included in the consideration for the supply; or

(c) the goods and services or part of those goods and services supplied have been returned to the supplier,—

and the supplier has—

(d) ***provided a tax invoice*** *in relation to that supply* ***and as a result of any 1 or more of the above events, the amount***

[11] Subsection (1B) reads; *For the purposes of subsection (1)(b), the previously agreed consideration for the supply of a pharmaceutical is not altered if part of the consideration for the supply has been rebated to Pharmac (acting on its own account or as an agent for a public authority) under a Pharmac agreement.*

*shown thereon **as tax** charged on that supply **is incorrect*** (emphasis added)*; or*

(e) furnished a return in relation to the taxable period for which output tax on that supply is attributable and, as a result of any 1 or more of the above events, has accounted for an incorrect amount of output tax on that supply.

The New Zealand Goods and Services Tax Guide also sets out the instances where Section 25 (1) of the New Zealand GST Act applies in relation to the supply of goods or services by any registered person.

Those instances are;

a) That supply of goods and services has been cancelled; or

aa) The nature of that supply of goods and services has been fundamentally varied or altered; or

*b) The previously agreed consideration for that supply of goods and services has been altered, **whether due to the offer of a discount or otherwise*** (emphasis added)*; or*

c) The goods and services or part of those goods and services supplied have been returned to the supplier,-

Clause 3.06 of the 2007 VAT Manual, published by the DIR also specifies the circumstances under which a tax credit note or a tax debit note could be issued under Section 25 of the VAT Act.

Those instances are;

1) The cancellation of a supply of goods or services.

2) The nature of that supply of goods or services has been altered.

3) The previously accepted consideration for the supply of the goods or services being changed.

4) Part of or all of the good or service is returned to the supplier.

The aforementioned four instances are almost identical to items (a), (aa), (b), and (c) of the New Zealand Goods and Services Tax Guide, even in the order of their appearance in the Manual.

Out of the aforementioned four instances in the 2007 VAT Manual, the item relevant to the instant case is item number 3) where the previously accepted consideration for the supply is changed. In the Sri Lankan Manual, the reasons for the change are not specified or suggested, whereas in the New Zealand Goods and Services Tax Guide, the clause '*whether due to the offer of a discount or otherwise*' has been included in item b).

While it is clear that the New Zealand GST Act has positively allowed discounts subsequent to the issuing of tax invoices, and held that scenario to fall within an *incorrect* amount of tax which can be adjusted, the fact that this suggestion is missing from the Sri Lankan VAT Act does not imply that adjustments arising from discounts have been disallowed under Section 25. The VAT Act has simply omitted the entire list of instances where the amount of VAT mentioned in a tax invoice is deemed to be incorrect, and the 2007 VAT Manual has listed these instances as above. When a post-sale volume discount is offered, the previously accepted consideration for the supply is changed, thus fulfilling the terms of the third instance provided in the VAT Manual.

The learned Senior State Counsel has submitted (paras. 70-71) that the UK VAT Guide (1991 Revision) categorically permits volume discounts, whereas the Sri Lankan VAT Act does not. In my view, the salient consideration in answering these questions of law is that the VAT Act has no express prohibition on the adjustment of tax through credit notes where post-sale discounts have been offered. Nor does the 2007 VAT Manual suggest a prohibition of tax adjustments on account of any type of discount. It may have done so had it specified a closed list of circumstances where item number 3) above could be utilised. I am therefore not prepared to accept this argument of the learned Senior State Counsel.

It has also been submitted on behalf of the Respondent (pp. 27-29, para. 132 ff.) that this Court should have regard to the decision in *Ultra Tech Cement Ltd. v. State of Kerala*,[12] where the Kerala High Court confirmed the decision of a lower Court that disallowed the deduction of post-sale discounts (awarded depending on sales targets achieved and the promptness of payment) from the taxable turnover.

In my view, this judgement has limited applicability to the instant appeal, for the following reasons. Firstly, the Court in the above Indian case relied

[12] W.A. No. 1565 of 2006 and connected cases

on a technicality whereby Form 8 of the VAT Rules had a specific field under which discounts had to be mentioned at the time of sale, which the Court interpreted restrictively to hold that where such discounts had not been mentioned in the invoice, they were to be disallowed:

"*Explanation specifically clarifies that any discount on the price allowed in respect of any sale* ***if shown separately*** *has to be excluded.*

(…)

In other words the meaning and scope of provisions before and after amendment are that no dealer is entitled to deduction of discount ***unless it is separately shown in the tax invoice*** *and the price collected is net of the discount* (emphasis added).".[13]

It is clear that the Court has placed emphasis on the clause *"if shown separately"* to mean that where it was not so shown, discounts could not be allowed. Neither our VAT Act nor the 2007 VAT Manual has such a provision to show discounts at the time of sale.

Secondly, this Indian precedent was set aside in the subsequent Supreme Court decision in the conjoined cases of *M/s IFB Industries Ltd. v. State of Kerala* and *India Cements Ltd. v. The Assistant Commissioner and Others*,[14] where it was held that post-sale discounts were indeed deductible from the taxable turnover, and that therefore, the above restrictive reading of the law by the Kerala High Court could not be allowed to stand.

Finally, it is important to note that the Supreme Court of India decided as above even though on a strict reading of the law, the provision that expressly allowed discounts at the time of sale could be interpreted to exclude performance-based post-sale discounts. In my view, not even on such a strict interpretation could post-sale discounts be disallowed under the provisions of the Sri Lankan VAT Act, since there is no specific allowance for discounts at the time of sale (which could then be interpreted strictly to exclude post-sale discounts), and the Assessor has still allowed them. Having so allowed trade discounts without any express provision for them, the State cannot rely on the above decision of the Kerala High Court to then deny post-sale discounts.

[13] *Supra* note 12, at para. 6
[14] (2012) 4 S.C.C. 618

The learned Senior State Counsel has submitted (paras. 39-51) that the phrase 'an incorrect amount of tax' found in Section 25 of the VAT Act ought to be interpreted to mean an amount of tax that has been mentioned on an invoice by either *mistake* or *error*. She has argued that out of the 4 instances mentioned in the 2007 VAT Manual, items 1), 2), and 4) refer to infrequent occurrences in practice, and that in interpreting item 3) which is the item the Appellant contends is applicable to the adjustment of tax owing to post-sale discounts, this Court should hold that the said item was not intended to be used to accommodate a regular practice of post-sale adjustment. She has thus argued for item 3) to also be used only in case of unforeseen circumstances, to make "one-off" adjustments (para. 151).

The learned Counsel for the Appellant has countered these submissions made on behalf of the Respondent by submitting (para. 65) that the term 'incorrect' ought not to be limited to 'error/mistake' alone. I find this argument to be convincing, particularly upon considering that none of the four instances listed in the 2007 VAT Manual arise owing to clerical error, and the fact that the said Manual has been published by the Respondent itself. Furthermore, I accept the Appellant's argument that all four of the above-said instances arise post-sale, and thus do not reflect mistakes made at the time of sale.

In my view, it does not matter exactly how the amount of tax mentioned on an invoice happens to be incorrect, so long as on the reflection of facts, it is incorrect. I am not prepared to read such considerations as frequency or error into the concise phrasing of Section 25, particularly where they appear indefensible given the Respondent's own interpretation of the section in the 2007 VAT Manual.

I therefore conclude that the term '*incorrect*' in Section 25 of the VAT Act can be interpreted to include tax adjustments necessitated through the offer of post-sale volume discounts. I dismiss the learned Senior State Counsel's submission (para. 68) that it is the fault of the Appellant that they are unable to include the correct value of supply on its invoices. There is a genuine practical inability to do so in the present case.

I am mindful of the fact that this Court is not bound by the guidelines issued by the DIR in the 2007 VAT Manual, unless they are given statutory force through a specific provision in the VAT Act. Yet, Assessors and the CGIR are bound to follow these guidelines in arriving at their decisions, and thus,

the Respondent cannot rely on arguments that are contrary to its own guidelines.

Since the interpretation of Section 25 (1) of the VAT Act in the 2007 VAT Manual is not binding on a Court or a Tribunal, in my view, the TAC cannot be held to have misdirected itself in law for failing to apply or consider the said interpretation. I therefore answer the ninth question of law in the negative. Having scrutinised the tenth question of law for a second time in this judgement, I answer it as I did previously, in the negative.

11. Does Section 25(1) of the VAT Act require a separate credit note for each tax invoice?

12. Is a single tax credit note in respect of all invoices issued to a customer for a particular taxable period contrary to the requirements of Section 25(1) of the VAT Act?

13. If so, is such requirement in Section 25(1) of the VAT Act mandatory or directory?

The learned Senior State Counsel, in her written submissions (paras. 52-75), has expressed her concern over the Appellant's customers potentially deceiving the CGIR by not disclosing the tax credit notes issued by the Appellant, and claiming VAT input on the initial tax invoices instead. It has also been submitted that since the Appellant's tax credit notes do not refer to one or more invoice by number, but instead adjust the VAT for a full taxable period, the State cannot cross check and make the correct deduction in case of such deception by the Appellant's customers. In this way, the learned Senior State Counsel has demonstrated that the State may lose revenue even though the particular transaction between the Appellant and its customers is VAT neutral after allowing for post-sale volume discounts through the use of tax credit notes.

In reply, the learned Counsel for the Appellant has submitted that the VAT Act has statutory provisions for the CGIR to obtain additional information, if necessary.[15] It has further been submitted that the VAT Act has made providing incorrect information a punishable offence,[16] and that the time-

[15] Section 21 (4) of the VAT Act
[16] Section 67 (h) of the VAT Act

bar applicable to Section 33 does not apply to fraud or wilful suppression, meaning that such acts may be investigated and prosecuted at any point after the particular transaction has taken place. Indeed, this Court does not deem it just for the Appellant to lose the benefit of VAT adjustment through the use of tax credit notes, simply because another party may attempt to cheat the State of its revenue. It is the responsibility of the DIR, and not that of the Appellant, to place such acts under scrutiny and secure its revenue.

In any case, the Court observes that although it has been submitted by the learned Senior State Counsel as above, the two tax credit notes ('A3') available in the brief refer to specific invoice numbers (8320 and 8329). Hence, the CGIR, without any difficulty, can cross check the relevant entries and arrive at a correct conclusion.

The learned Senior State Counsel has submitted further (para. 127) that the tax credit notes issued by the Appellant are not in the proper format as prescribed in the 2007 VAT Manual. She has advocated that as the Appellant has not adhered to the said format, it is in violation of Section 25 of the VAT Act (paras. 153, 154, and 157). There is no doubt that the learned Senior State Counsel is relying on Section 25 (3), which reads:

> *'The tax debit note or tax credit note referred to in subsection (1) shall be in the specified form.'*

It is indeed true that upon comparing the tax credit notes in the brief ('A3') to the model credit notes provided in the VAT Manual, the fields named 'date of the tax invoice' and the 'reason for change' are not reflected in the Appellant's version. Nevertheless, this was not mentioned by the Assessor in his intimation letter as a reason for denying VAT adjustment on the Appellant's volume discounts, and nor was it in issue before either the CGIR or the TAC. Furthermore, it was not brought up in argument before this Court. However, despite the fact that the learned Senior State Counsel has in effect advocated a new position, and the fact that the date of the tax invoice can be traced using the invoice number, I will now consider this matter further.

The learned Counsel for the Appellant has responded to these issues raised on behalf of the Respondent by submitting (para. 93) that the format provided in the 2007 VAT Manual is meant to act as a guide, and that it has no statutory force. He has further submitted that such a binding format

for tax credit notes can only exist where they are prescribed by the Minister through Regulations and published in the Gazette in accordance with Section 75, followed by Parliamentary approval. I am willing to accept the learned Counsel's submission, upon perusing Section 64 and Section 75 of the VAT Act, which I have reproduced below:

> ***64.*** *(1) Every registered person shall keep and maintain* ***records in respect of the taxable activity carried on or carried out by him*** *to enable the Commissioner-General or any other officer authorised by the Commissioner-General or that behalf to ascertain the liability for the payment of the tax* (emphasis added).
>
> *(2) The* ***form of the records****, to be maintained under subsection (1)* ***and the particulars to be set forth therein shall be as prescribed*** (emphasis added).
>
> *(3) For the purpose of this section "****records****" includes –*
>
> *(a) books of account, (whether contained in a manual, mechanical or electronic format or combination thereof) recording receipts or payments or income or expenditure and also includes vouchers, bank statements, invoice tax invoices,* ***tax credit notes****, tax debit notes, receipts and such other documents as are necessary to verify the entries in any such books of account* (emphasis added)*;*
>
> *(b) details of any warehouse, go-down or any other place where stock of goods are kept and the stock of goods kept in such warehouses, go-down, or any other place, as the case may be;*
>
> *(c) any list or record required to be maintained or kept in accordance with the provisions of this Act* ***or under any regulations made thereunder*** (emphasis added).

> ***75.*** *(1) The Minister may make regulations* ***in respect of matters required by this Act to be prescribed*** *or in respect*

of matters authorised by this Act to be made (emphasis added).

(2) Every regulation made by the Minister shall come into operation on the date of its publication in the Gazette or on such date as may be specified in the regulation.

(3) Every regulation shall within two months after its publication in the Gazette, be brought before Parliament for approval. Any such regulation which is not so approved shall be deemed to be rescinded as from the date of disapproval but without prejudice to anything previously done thereunder. A notification of the date on which a regulation is deemed to be rescinded shall be published in the Gazette.

It is clear that under Section 64 (3) (a), tax credit notes fall under 'records' as specified in Section 64 (1). It is also clear from Section 64 (2) read with Section 25 (3) that the *form* of these records as well as *the particulars to be set forth therein* shall be as prescribed. Since the Act itself does not prescribe either the form or the content of a tax credit note, the Minister is empowered to do so under Section 75 (1), read with Section 64 (2).

It could be argued that since Section 74 allows the CGIR to specify '*forms'* to be used for the purposes of the VAT Act, and that since Section 25 (3) mentions that the tax credit note shall be '*in the specified form*', the form specified in the 2007 VAT Manual has statutory force. Section 74 reads as follows:

74. *The Commissioner-General may from time to time* ***specify the forms to be used*** *for all or any of the purposes of this Act, and any form so specified may from time to time be amended or varied by the Commissioner-General or some other form may be substituted by the Commissioner-General in place of any form so specified* (emphasis added).

In my view, Section 25 (3) makes reference to the *format* a tax credit note must follow,[17] and it does not mention who must specify this format. Section 74 allows the CGIR to specify *forms*, as in

[17] The word 'form' being used here in the same sense as that in which it is used in Section 64 (2)

'*a printed document with blank spaces for information to be inserted*'.[18] Therefore, it cannot be held on a reading of these two provisions together that the CGIR has the authority to specify the format of tax credit notes as required under Section 25 (3). In any case, Section 64 read with Section 75 leaves no ambiguity as to who has the authority to prescribe the form and content of tax credit notes, as they have been categorically included under 'records' in Section 64 (3) (a).

Having considered the above submissions, I hold that the Appellant is not in contravention of Section 25 owing to its failure to adhere to the format for tax credit notes made available through the 2007 VAT Manual, since the said format is not binding on taxpayers.

The learned Senior State Counsel has argued separately (paras. 29-33) that there must be a separate tax credit note issued per tax invoice, even if they are for the same taxable period and the same customer. On the contrary, the only constraints on tax credit notes in terms of Section 25 (1) and (2) of the VAT Act appear to be the six-month time limit specified in the proviso, and the fact that only those tax invoices belonging to a single taxable period must be included. It appears that the Appellant has acted within these two constraints.

For this Court to endorse the strict reading of Section 25 (1) that the learned Senior State Counsel advocates, the Legislature would have to have used the word 'each' in the proviso to subsection (1), in order to introduce a requirement of exclusivity, so that it reads:

> '*Provided however, the adjustment in respect of input tax under claimed on ~~an~~* ***each*** *original tax invoice shall be made in respect of a tax debit note or a tax credit note issued not later than six months after the issue of the original tax invoice, to which the tax debit note or the tax credit note relates* (original struck-through, alteration in bold).'.

However, the Legislature has not phrased the proviso thus, and this Court is not prepared to read it as strictly as the learned Senior State Counsel would have it read. Furthermore, the Assessor has not rejected the VAT returns of the Appellant on the basis that each invoice requires a separate tax credit note. The rejection has only come under the grounds that Section 25 of the VAT Act does not permit the deduction of VAT on post-sale

[18] Angus Stevenson, *Oxford Dictionary of English*, Third Edition, 2010.

volume discounts, and this has been confirmed by both the CGIR and the TAC. It must also be noted that the 2007 VAT Manual published by the Respondent itself allows the listing of more than one tax invoice in a given tax credit note.

In any case, Bindra states on the interpretation of fiscal statutes that:[19]

"*It is a well-known principle of interpretation that when construing a fiscal statute, the court has to lean in its interpretation in favour of the subject, rather than in favour of the State.*".

In keeping with the above principle, and for the reasons set out above, it is my view that the Appellant's returns should not be rejected for the reason that it did not issue an individual tax credit note per tax invoice. Such a requirement cannot be read into Section 25, and adjustment of tax on invoices should be allowed under Section 25 so long as a tax credit note makes specific reference to the tax invoices it lists. In this way, a tax invoice is always traceable to a specific tax credit note, thus satisfying the requirements of the VAT Act.

For the abovementioned reasons, I answer the eleventh and twelfth questions of law in the negative. Having so answered the twelfth question, the thirteenth question of law does not arise.

14. Does a discount have to be made "on the basis of the price of the product" for the purpose of applicability of Section 25(1) of the VAT Act?

There is no requirement under Section 25 (1) of the VAT Act that a discount has to be made on the basis of the price of a product, though it may sometimes be so made. In the instant case, neither of the types of discount is based on the price of the product.

I therefore answer the fourteenth question of law in the negative.

16. Did the Commission misdirect itself in law at page 11 concluding that a discount based on the volume of the supply is "similar to an incentive payment" in the absence of any legal basis to equate a discount as being similar to an incentive payment?

One can interpret a discount as an incentive. It is obvious that in commerce, volume discounts are offered to induce more purchases. Yet, the core issue

[19] *Supra* note 8, at p.672

in the instant case is whether the deduction of such discounts could be allowed in the calculation of VAT.

Since this observation of the TAC did not require a specific basis in law, I hold that the TAC did not misdirect itself in law and answer the sixteenth question of law in the negative.

17. ***Did the Commission misdirect itself at page 11 of the determination in concluding that a "'volume discount' is not a discount freely offered and made among persons" in the absence of any evidence in support of such conclusion?***

There does not appear to be any evidence to support the TAC's conclusion that a volume discount is not a discount *freely offered and made between persons*, which is a requirement under the definition provided for open market value in Section 83 of the VAT Act.

I therefore hold that the TAC did indeed misdirect itself at page 11 of its determination, and answer the seventeenth question of law in the affirmative.

18. ***Did the Commission misdirected* (sic) *itself in law in failing to reduce or annul the amount payable as penalty in terms of Section 27(1) of the VAT Act in view of the accumulated input tax credit that was due to the Appellant from the Department of Inland Revenue?***

19. ***Has the Commission misdirected itself in law in failing to appreciate that the Commissioner General of Inland Revenue ought to have reduced the penalty in terms of the proviso to Section 27(1) of the VAT Act in view of the accumulated input tax credit that was due to the Appellant from the Department of Inland Revenue?***

The learned Counsel for the Appellant has submitted that should the principal submission be answered in favour of the Appellant, these two questions of law would not arise.

I therefore hold that the eighteenth and nineteenth questions of law do not arise.

21. ***Has the Commission misdirected itself in law in determining that the VAT in dispute in this case is only the balance tax payable amounting to Rs. 9,766,684/- when the Assessor has assessed an additional VAT***

liability of Rs. 65,111,240/- and the Commissioner General of Inland Revenue has confirmed it?

This question is trivial since it has been determined above in this judgement that the Appellant is to be allowed to deduct VAT on its volume discounts. Nevertheless, the TAC was correct in determining that the tax in dispute amounts to Rs. 9,766,684. This can be seen in the annexure to the Assessor's letter of intimation dated 24th April 2010.

The figure of Rs. 65,111,240 is the additional VAT *liability* on the volume discount. However, once all calculations are done, the *balance payable* is Rs. 9,766,684.

For the avoidance of doubt, I hold that the Appellant is not liable to pay any VAT or any penalties arising from such VAT liability, in relation to the assessments made on its volume discounts for the relevant tax window.

I therefore answer the twenty-first question of law in the negative.

Accordingly, I answer the first, fourth, fifth, sixth, seventh, fifteenth, seventeenth, and twentieth questions of law in the affirmative; and the second, third, eighth, ninth, tenth, eleventh, twelfth, fourteenth, sixteenth, and twenty-first questions of law in the negative. Having so answered those questions of law, the thirteenth, eighteenth and nineteenth questions of law do not arise.

In light of the answers given to the above questions of law, acting under Section 11 A (6) of the TAC Act, I annul the additional assessments determined by the TAC on the volume discounts.

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

JUDGE OF THE COURT OF APPEAL

Dr. Ruwan Fernando J.

I Agree.

JUDGE OF THE COURT OF APPEAL