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 36 of the Value Added Tax Act, No. 14 of 2002 (as amended), read with section 141 of the Inland Revenue Act, No. 38 of 2000 (as amended) and the provisions of the Tax Appeals Commission Act, No. 23 of 2011 (as amended).

Unilever Sri Lanka Limited,
258, M. Vincent Perera Mawatha,
Colombo 14.

Appellant

Case No. CA/TAX/0015/2013
Tax Appeals Commission
No. TAC/VAT/010/2011

Vs.

Commissioner General of Inland Revenue,
Department of Inland Revenue,
Sir ChittampalamA.Gardiner Mawatha,
Colombo 02.

Respondent

Before **:** Dr. Ruwan Fernando J. &

M. Sampath K.B. Wijeratne J.

Counsel : Dr K. Kanag-Isvaran, P.C. with Dr. Shivaji Felix with Shivaan Kanag-Isvaran for the Appellant

Farzana Jameel, P.C., S.A.S.G. with
Suranga Wimalasena, D.S.G. and
Shiloma David, S.C. for the Respondent

Argued on	:	21.03.2022
Written Submissions filed on	:	02.06.2022, 23.07.2018, 17.09.2018 & 30.09.2019 (by the Appellant) 07.06.2022, 30.09.2019 & 26.07.2018 (by the Respondent)
Decided on	:	04.11. 2022

Dr. Ruwan Fernando, J.

Introduction

[1] This is an appeal by way of a case stated against the determination of the Tax Appeals Commission dated 07.03.2013 confirming the determination made by the Commissioner General of Inland Revenue on 14.11.2011 and dismissing the Appeal of the Appellant.

Factual Background

[2] The Appellant, Unilever Sri Lanka Ltd is a limited liability company duly incorporated and domiciled in Sri Lanka and carries on the business of manufacturing, producing, marketing and distributing a variety of household items. The Appellant's household items include soap, soap powder, detergents and toilet requisites, and cosmetics under the brand names/trademarks owned by Unilever PLC of the United Kingdom.

[3] The said Unilever PLC, which was incorporated in England and the owner of internationally well-known trademarks on a variety of goods, entered into a Trade Mark Licence Agreement with the Appellant on 01.01.2003 in respect of all those products listed in Schedule 'B' of the said Agreement under the trade marks specified in the agreement. In terms of the said agreement, the Appellant became the sole and only licensee to use the trademarks on a non-transferable basis in direct connection with the manufacture, packaging, advertising and sale of the products in the territory of the Maldives under the trade marks specified in the said agreement.

[4] The Appellant entered into an agreement with R. M. Chemicals Ceylon (Pvt.) Limited (hereinafter referred to as the RMCC) on 14.05.2009 for a period of five

years commencing from 01.01.2008 to 31.12.2012. In terms of the agreement between the Appellant and RMCC, RMCC shall manufacture vim dish wash bars bearing the Appellant's trademarks, and supply the same to the Appellant subject to the terms and conditions of the agreement.

[5] The Appellant entered into an agreement with Polypak Secco Limited (hereinafter referred to as the PSL) on 30.08.2005, and in terms of the said agreement, PSL shall manufacture toothbrushes bearing the Appellant's trademarks, and supply the same to the Appellant subject to the terms and conditions of the agreement.

[6] The Appellant claimed that, in terms of the said agreements, RMCC and PSL are the manufacturers and suppliers of the said products, and the Appellant is only engaged in buying and selling of such products. The Appellant's position is that the Appellant is not engaged in the manufacturing activities which statutorily constitute "manufacture" in section 83 of the VAT Act, and therefore, it's not the manufacturer within the meaning of section 3(1)(a) of the VAT Act.

[7] The Appellant submitted its VAT returns for the monthly taxable periods of 12 months from 01st January 2008 to 31st December 2008 on the sale of its trademarked products (Vim dish wash bars and Signal toothbrushes) and claimed that it is not liable to pay VAT on the value of supply of the said products. The dispute related to the question whether the Appellant is liable to pay Value Added Tax (VAT) for the monthly taxable periods of 12 months from January 2006 to December 2008, on the sale of its trademarked tooth brushes and vim dish wash bars made by RMCC and PSL under the aforesaid agreements. The VAT in dispute amounted to Rs. 1,208,401,265.

[8] The Assessor by letter dated 10.08.2010 refused to accept the VAT returns for the relevant 12-month period from January 2008 to December 2008. The Assessor decided that for the following reasons, and several other reasons more fully set out in the said letter, the Appellant is liable to pay VAT on the value of supplies of Signal tooth brushes and vim dish wash bars as the manufacturer for the purposes of the VAT Act:

1. Taxable supplies derived from the supply of toothbrushes and vim dish wash bars have not been included in the VAT returns. The undeclared value of supplies during the year 2008 is as follows:

Year	Tooth Brush and Vim Dish Wash Bars
2008	1,208,401,265

2. The ownership of the trademarks and trade names of VIM Scourer bars (vim dish wash bars) and Signal Tooth Brushes belongs to Unilever PLC in England and, other than Unilever Sri Lanka Ltd (USL), is not permitted to use the above trademarks and trade names in Sri Lanka. Hence, the exclusive owner of the trademarks and trade names in Sri Lanka is Unilever Sri Lanka Ltd;

3. The required quantity of each product is decided by the Unilever Sri Lanka Ltd and once the required quantity is produced by each party, the Unilever Sri Lanka Ltd becomes the exclusive owner of those products and therefore those producers have no selling rights of those products;

4. The sole selling right of goods belongs to Unilever Sri Lanka Ltd, since the manufactured goods become the property of Unilever Sri Lanka Ltd and RMCC and PSL produced goods under the service agreement on behalf of Unilever Sri Lanka Ltd;

5. Unilever Sri Lanka Ltd is the sole authorized person in Sri Lanka to manufacture and sale the products bearing the trademarks owned by the Unilever, U.K. In terms of the agreements:

6. Vim dish wash bars are manufactured by RMCC and Signal tooth brushes are manufactured by PSL, exclusively on behalf of the Appellant because RMCC and the PSL have no authority to manufacture or sell the said products without the permission of the Appellant;

[9] Accordingly, the notices of assessment were issued by the Assessor, and being dissatisfied with the said assessments, the Appellant appealed to the Commissioner General of Inland Revenue (hereinafter referred to as the Respondent). The Respondent in its reasons for the determination stated that:

a. The manufacturing of toothbrushes by PSL and manufacturing of vim dish wash bars by RMCC were done solely on the specifications and brand names given by Unilever PLC UK with whom the Appellant had entered into a Trade Mark License Agreement;

b. RMCC and PSL have no right to use their own specifications for manufacturing the same products or sell them to any other parties;

c. Therefore, all manufactured items are to be sold only to the Appellant (p. 12 of the TAC brief).

[10] The Respondent in its determination dated 14.11.2011 decided that the Appellant is engaged in the supply of goods and therefore, such supplies can be treated as a taxable activity within the meaning of the VAT Act (pp 12-13 of the TAC brief). Accordingly, the Respondent confirmed the assessments made by the Assessor.

Appeal to the Tax Appeals Commission & the Court of Appeal

[11] Being dissatisfied with the said determination of the Respondent, the Appellant appealed to the Tax Appeals Commission (hereinafter referred to as the TAC). The issue before the TAC was whether the supplies of vim dish bars and signal tooth brushes made during the taxable periods are "taxable supplies" for the purpose of the VAT Act, No. 14 of 2002. The TAC in its determination dated 07.03.2013 stated:

> *"There are three conditions to be fulfilled to render a supply liable for VAT in terms of section 2 of the VAT Act, namely, (a) the supply should be a taxable supply of goods or services; (b) it is to be made by a VAT registered person, and; (c) it (supply) is made in the course of the carrying on, or carrying out, of a taxable activity.*
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> *The contention of the Appellant is that the value of the supplies made by the Appellant Company is not liable for VAT in terms of section 3 of the VAT Act, since the aforementioned first condition is not fulfilled in the present case. However, in view of the material referred to above, it is clear that the said supplies are to be treated as "taxable supplies", as the Appellant Company is the manufacturer of both products and accordingly, all the three conditions are not fulfilled in the present case.*
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> *In the circumstances, the supply of VIM Dish Wash Bars and Signal Tooth Brushes made during the twelve taxable periods from January, 2008 to December, 2008 are to be determined as "taxable supplies" for the purpose of the Value Added Tax Act, No. 14 of 2002".* [p. 296 of the TAC brief].

[12] The TAC concluded that the Appellant is the manufacturer and the supplier in respect of both products, and such supplies are to be treated as "taxable supplies" for the purposes of the VAT Act. Accordingly, the TAC dismissed the appeal.

Appeal to the Court of Appeal & questions of Law

[13] Being dissatisfied with the determination of the TAC, the Appellant appealed to the Court of Appeal by way of a case stated, and the TAC formulated the following questions of law in the case stated for the opinion of the Court of Appeal:

1. Did the Tax Appeals Commission err in law when it confirmed the determination made by the Respondent?
2. Is the determination of the Tax Appeals Commission time barred by operation of law?
3. Did the Tax Appeals Commission err in law when it came to the conclusion that the Appellant was a manufacturer for the purpose of the assessments?
   (a) Is the determination of the Tax Appeals Commission against the weight of evidence?
   (b) In view of the facts and circumstances of the case, did the Tax Appeals Commission err in law when it came to the conclusion that it did?

[14] We heard Dr. Kanag-Iswaran, P.C. and Dr. Shivaji Felix for the Appellant and Mrs. Farzana Jameel, the Senior Additional Solicitor General for the Respondent on all the questions of law.

Analysis

Question of Law No. 2-Time bar of the TAC determination

[15] I shall first consider the question of law No. 2 which relates to the question whether the determination of the TAC is time barred by operation of law. The learned Counsel for the Appellant submitted that (i) the first date of the oral hearing of the appeal by the TAC was on 12.06.2012 and the determination was made on 07.03.2013; (ii) the operative date for the commencement of the time bar is the date on which the Appellant submitted itself to the jurisdiction of the TAC by tendering the petition of appeal dated 23.02.2012 to the TAC on **24.02.2012**; (iii) In view of the fact that the Tax Appeals Commission (Amendment) Act, No. 4 of 2012 has retrospective operation, it is deemed to have come into operation on 31.03.2011, and therefore, the appeal would have been time barred prior to 12.03.2013.

[16] The learned Counsel for the Appellant submitted that the term "hearing" as used in section 10 of the Tax Appeals Commission Act, No. 23 of 2011 (as amended prior to 2013), does not refer to an oral hearing. His contention was that the word "hearing" in that context has the same meaning as "to hear and determine" referring to Stroud's Dictionary (London, Sweet & Maxwell, 7thedn. Vol. 2). He submitted, therefore, that the "hearing" does not commence with the oral hearing, but at a point anterior to it, when a party submits to the jurisdiction of a tribunal. The Appellant's argument is that the hearing in the case commenced prior to the date of the oral hearing on 12.06.2012 and therefore, when the determination was made on 07.03.2013, the Appellant's appeal before the TAC was time barred by operation of law.

[17] The learned Senior Additional Solicitor General however, countered the submission of the Appellant and submitted that the word "hearing" in section 10 of the Tax Appeals Commission Act, No. 23 of 2011 is clearly an 'oral hearing' as determined by the Court of Appeal in *Mohideen v. Commissioner General of Inland Revenue* (2015) XXI BASL Law Journal p. 171). She submitted that the first oral hearing was on 12.06.2012 and the determination was made on 07.03.2013 and accordingly, the determination of the TAC has been made within a period of 270 days as required by the Tax Appeals Commission Act, No. 23 of 2011 (as amended).

[18] The learned Senior Additional Solicitor General further submitted that the time limit specified in Section 10 of the Tax Appeals Commission Act, No. 23 of 2011 is not mandatory, but rather directory, and the failure to adhere to the time limit specified in the Tax Appeals Commission Act, No. 23 of 2011 cannot render the TAC *functus officio* to hear and determine the appeal. She relied on the decisions of this Court in *Stafford Motor Company Limited v. The Commissioner General of Inland Revenue* (CA /Tax/17/2017, decided on 15.03.2019).

[19] The time limit for the determination of appeals by the Tax Appeals Commission was originally contained in Section 10 of the Tax Appeals Commission Act, No. 23 of 2011, which stipulated that the Tax Appeals Commission shall make the determination within a period of **one hundred and eighty days** from the date of the commencement of the hearing of the appeal. It reads as follows:

> *"The Commission shall hear all appeals received by it and make its decision in respect thereof, within **one hundred and eighty days** from the date of the commencement of the hearing of the appeal".*

[20] Section 10 of the Tax Appeals Commission Act, No. 23 of 2011 was amended by Section 7 of the Tax Appeals Commission (Amendment) Act, No. 4 of 2012, which stipulated that the determination of the Commission shall be made within **two hundred and seventy days**. In terms of Section 13 of the said Act, the amendment was to have retrospective effect and was deemed to have come into force from the date of the Principal Act (i.e. 31.01.2011). Accordingly, Section 10 of the Tax Appeals Commission Act, No. 23 of 2011 as amended by the Tax Appeals Commission (Amendment) Act, No. 04 of 2002 read as follows:

> *"The Commission shall hear all appeals received by it and make its determination in respect thereof, within **two hundred and seventy days from the date of the commencement of the hearing of the appeal".***
>
> *Provided that, all appeals pending before the respective Board or Boards of Review in terms of the provisions of the respective enactments specified in the Schedule to this Act, shall with effect from the date of coming into operation of this Act be deemed to stand transferred to the Commission, and the Commission and the Commission shall make its determination in respect of thereof, within twelve months of the date on which the Commission shall commence its sittings notwithstanding anything contained in any other written law."*

[21] However, the amended Act, No. 4 of 2012 only amended the period for the determination of the appeal from 180 days to 270 days from the date of the hearing. Accordingly, the fact that the Tax Appeals Commission (Amendment) Act, No. 4 of 2012 was retrospective operation, and deemed to have come into operation from 31.03.2011, will make no difference since the amended Act did not take away the word "hearing", which is nothing but "oral hearing" as held by Gooneratne, J. in *Mohideen v. Commissioner-General of Inland Revenue* (supra),

[22] The question that arose for decision in *Mohideen v. Commissioner-General of Inland Revenue* (supra), was whether the commencement of the time bar as contemplated in section 140 (10) of the Inland Revenue Act, No. 38 of 2000 will operate from the date on which the Appellant submitted to the jurisdiction of the Board of Review according to the Appellant, on receipt of the Petition of Appeal by the Board or from the date of the oral hearing. Section 140 (10)

of the Inland Revenue Act, No. 38 of 2000 as amended by Section 52 of the Inland Revenue (Amendment) Act, No. 37 of 2003 contained 2 provisos, and the intention as regards time limit is reflected in the second proviso to section 140 (10), which reads as follows:

> *"Provided, however, the Board shall make its determination or express its opinion as the case may be, **within two years** from the date of commencement of the hearing of such appeal."*

[23] The submission of the Appellant in that case was that the legislative intention was to dispose of both appeals within **a total period of four years and** the time limit of 2 years will begin to operate from the date on which the **Petition of Appeal is received** by the Board of Review, and **not from the date of the oral hearing**. The State argued however that the legislative intention by the use of the word "hearing" in section 140(10) of the Inland Revenue Act, No. 38 of 2000 means an "oral hearing" and no more". His Lordship Gooneratne J. answered this question at pp. 176-177 as follows:

> *"It is very unfortunate that it took almost 6 ½ years or more to reach its conclusion from the date of filing the Petition of Appeal in the Board. But the oral hearing commenced on 21.06.2006. This of course is well within the time limit and I would go to the extent to state that the Board has been very conscious of early disposal of the appeal. The Board cannot be faulted for getting the appeal fixed for hearing as stated above, since it is the duty and function of the Secretary of the Board to fix a date and time for hearing and to notify the parties. If it was the intention of the legislature that hearing should be concluded within 2 years from the date of filing the petition or that the time period of 2 years begins to run from the date of filing the petition, there could not have been a difficult to make express provision, in that regard. I do agree with the view of the State Counsel. **Hearing no doubt commences from the date of oral hearing. I would as such answer this question in favour of the Respondent and endorse the view of the Board of Review.** It is not time barred as the Board arrived at the determination within 2 years." [Emphasis added]*

[24] For those reasons, His Lordship Gooneratne J. having considered the question involved (Question No. 2), held with the Respondent on the basis that the hearing for the calculation of time limit of 2 years specified in section 140 (10) commences 'from the date of the oral hearing' and 'not from the date of filing of the petition of appeal'. I have no reason to deviate from the view taken by Gooneratne, J. in *Mohideen v. Commissioner-General of Inland Revenue* (supra). I hold that when the legislation provides that when the Commission shall hear all appeals received by it and make its determination, **within two**

hundred and seventy days of the time of the commencement of the hearing of the appeal [(prior to the Tax Appeal Commission (Amendment) Act, No. 20 of 2013)], the hearing commences ***from the date of oral hearing.*** The oral hearing in the present case commenced on 12.06.2012 and the determination was made by the TAC on 07.03.2013 and therefore, the determination of the appeal by the TAC is not time barred in terms of section 10 of the Tax Appeals Commission Act, No. 23 of 2011 as amended by the Tax Appeals Commission (Amendment) Act, No. 04 of 2012.

[25] I will now turn to the submission made by the learned Senior Additional Solicitor General that the word "shall" used in section 10 is normally to be interpreted as connoting a (directory) and not mandatory provision. She submitted that the effect of any breach does not render the determination invalid in the absence of any consequences being specified in the legislation. Her submission was that the Tax Appeals Commission Act does not spell out any sanction for the failure on the part of the Tax Appeals commission to comply with the time limit set out in section 10 of the Tax Appeals Commission Act. She invited us to hold that the time limit set out in section 10 of the Tax Appeals Commission Act is only directory, and not mandatory.

Mandatory-directory classification

[26] Section 10 of the Tax Appeals Act stipulates that the Tax Appeals Commission **shall** make its determination within 270 days of the commencement of the hearing of the appeal. Superficially, the effects of non-compliance of a provision are dealt with in terms of the mandatory-directory classification. Generally, in case of a mandatory provision, the act done in breach thereof is void, whereas, in case of a directory provision, the act does not become void, although some other consequences may follow (P.M. Bakshi, Interpretation of Statutes, First Ed, 2008). But, the use of the word "shall" does not always mean that the provision is obligatory or mandatory, as it depends upon the context in which the word "shall" occurs and the other circumstances (Vide-Indian Supreme Court case of *The Collector* of *Monghyr v. Keshan Prasad Goenka,* AIR 1962 SC 1694 at p. 1701).

[27] Section 10 of the Tax Appeals Commission Act, No. 23 of 2011 (as amended) does not say what will happen if the TAC fails to make the determination within the time limit specified in Section 10 of the Tax Appeals Commission Act, No. 23 of 2011 (as amended). It is true that the absence of any provision does not necessarily follow that the statutory provision is intended by the legislature to be disregarded or ignored. Where the sanction

for not obeying them in every particular statute is not prescribed, the court must judicially determine whether the legislature intended that the failure to observe any provision of a Statute would render an act null and void or leave it intact (see also, N.S. Bindra's Interpretation of Statute, 10th Ed. p. 1013).

[28] The question as to whether a statute is mandatory or directory is a question which has to be adjudged in the light of the intention of the Legislature as disclosed by the object, purpose and scope of the statute. If the statute is mandatory, the act or thing done, not in the manner or form prescribed can have no effect or validity, and if it is a directory, a penalty may be incurred for non-compliance, but the act or thing done is regarded as good (P.M. Bakshi, Interpretation of Statutes, p. 430 & *Mohanlal Ganpatram v. Shri SayajiJubliee Cotton and Jute Mills Co. Ltd* AIR 1966 Guj. 96). *In State of U.P., v. Baburam Upadhya*, reported in AIR 1961 SC 751, the Supreme Court of India said that when a statute uses the word "shall", prima facie, it is mandatory, but the Court may ascertain the real intention of the legislature by carefully attending to the whole scope of the statute.

[29] In the absence of any express provision, the intention of the legislature is to be ascertained by weighing the consequences of holding a statute to be directory or mandatory, having regard to the importance of the provision in relation to the general object intended to be secured by the Act [*(Caldow v. Pixcell* (1877) 1 CPD 52, 566) & *Dharendra Kriisna v. Nihar Ganguly* (AIR 1943 Cal. 266)]. As held in *Attorney General's Reference (No 3 of 1999),* the emphasis ought to be on the consequences of non-compliance, and asking the question whether Parliament can fairly be taken to have intended total invalidity.

[30] Although the Tax Appeals Commission Act, No. 23 of 2011 (as amended) was amended by Parliament twice and increased the period within which the appeal is to be determined by the Commission from 200 days to 270 days with retrospective effect, the legislature in its wisdom did not specify any penal consequence or any other consequence of non-compliance of the time bar specified in section 10 of the Tax Appeals Commission Act. Had the legislature intended that the non-compliance with section 10 to be mandatory, it could have easily included a provision with negative words requiring that an act shall be done in no other manner or at no other time than that designated in the section or a provision for a penal consequence or other consequence of non-compliance.

[31] The legislature in its wisdom has placed time limit for the speedy disposal of appeals filed before the Commissioner-General, and the overall legislative intention sought to be attained by the Inland Revenue Act in section 165 (14) was to ensure that an appeal before the Commissioner-General of Inland Revenue is disposed of within a period of 2 years from the date on which the Petition of Appeal is received. As the Commissioner-General is an interested party against another interested party (tax payer) in the tax collection, it shall determine the appeal within 2 years from the receipt of the Petition of Appeal and if not, the appeal shall be deemed to have been allowed and tax charged accordingly, so as to safeguard the rights of the taxpayer

[32] The object sought to be attained by section 10 of the Tax Appeals Commission Act has been designed primarily to expedite the appeal process filed before the Tax Appeals Commission, which was established by an Act of Parliament, comprising retired Judges of the Supreme Court or the Court of Appeal, and those who have gained wide knowledge and eminence in the field of Taxation.

[33] The legislature has, from time to time, extended and reduced the time period within which the appeal shall be determined by the Tax Appeals Commission, but it intentionally and purposely refrained from imposing any consequence for the failure on the part of the Tax Appeals Commission to adhere to the time limit specified in section 10. It is crystal clear that these procedural time limit rules have been devised by the legislature to facilitate the appeal process by increasing and reducing the time period within which such appeals shall be concluded. The provision for the determination of an appeal by the Tax Appeals Commission within a period of 270 days from the commencement of its sittings for the hearing of an appeal. It has been designed to regulate the duties of the Tax Appeals Commission by specifying a time limit for its performance as specified in section 10 of the Act.

[34] The legislature could not have intended that the time limit specified in section 10 is mandatory when the parties had no control over those entrusted with the task of making the determination under section 10 of the Tax Appeals Commission Act.

[35] In *Stafford Motor Company Limited v. The Commissioner General of Inland Revenue (supra),* Janak de Silva, J. held that the Tax Appeals Commission Act, No. 23 of 2011 (as amended) does not spell out any sanction for the failure on

the part of the Tax Appeals commission to comply with the time limit set out in section 10 of the Tax Appeals Commission Act.

[36] We took the same view in our judgments in *Mr. S.P. Muttiah v. The Commissioner General of Inland Revenue,* CA/TAX/46/2019, decided on 26.06.2021 and *Amadeus Lanka (Pvt) Ltd v. CGIR* (C.A Tax 4/19 decided on 30.07.2021. In *Mr. S.P. Muttiah v. The Commissioner General of Inland Revenue*, we further held that the directory interpretation of Section 10 is consistent with the object, purpose and design of the Tax Appeals Commission Act, which is reflected in the intention of the legislature. We held that if a gap is disclosed in the Legislature, the remedy lies is an amending Act and not in a usurpation of the legislative function under the thin disguise of interpretation.

[37] In *S.P. Muttiah v. Commissioner General of Inland Revenue* (supra), this Court held at page 77 and 78;

> *"If we interpret the legislative intent of Section 10 from its mere phraseology, without considering the nature, purpose, the design, the absence of consequences of non-compliance and practical impossibility, which would follow from construing it one way or the other, it will tend to defeat the overall object, design, the purpose and spirit of the Tax Appeals Commission Act".*

[38] The directory interpretation of Section 10 is consistent with the object, purpose and design of the Tax Appeals Commission Act, which is reflected in the intention of the legislature. In the result, I hold that the determination of the Tax Appeals Commission in the present case is not time barred and thus, I answer the Question of Law No. 2 in favour of the Respondent.

Questions of Law, No. 1 & 3

Is the Appellant the manufacturer as contemplated by section 3(1)(a) of the VAT Act?
If not, whether the determination of the Tax Appeals Commission was against the weight of evidence?
If so, whether the Tax Appeals Commission was correct in confirming the determination made by the Respondent?

[39] The next question is to decide, whether from the facts and circumstances of the case, the Appellant can be treated as the manufacturer of the products in question within the meaning of section 3(1)(a) of the VAT Act, No. 14 of

2002. At the hearing Dr. Kanag-Isvaran submitted that in terms of section 3 of the VAT Act, the wholesale and retail supply of goods is exempted from the VAT unless the said wholesale or retail supply of goods is carried out by a manufacturer or importer of such goods sold by the retailer or wholesale supplier. Dr. Kanag-Isvaran further submitted that section 83 of the VAT Act defines the term "manufacture", and in terms of the definition, it must be established by the Respondent that the Appellant is engaged in the manufacturing activity of making of an article. His contention was such activity shall relate to the assembling or joining of an article by whatever process adapting for sale any article, packaging, bottling, putting into boxes, cutting, cleaning, polishing, labelling or in any other way preparing an article for sale other than in a wholesale or retail activity.

[40] Dr. Kanag-Isvaran submitted that no part of the agreement entered into between RMCC/PSL with the Appellant indicates that the Appellant is undertaking a manufacturing function, and the manufacturing function is undertaken by RMCC and PSL. His submission was that the Appellant has not in any way participated or engaged in any of the activities referred to, under the definition "manufacture" in section 83 of the VAT Act. He submitted that RMCC and PSL who run their own business in their own facilities and purchase their raw material and manufactured the products in question with their own labor and own expertise. He contended that in the present case, RMCC and PSL are physically engaged in contract manufacturing activities, and manufactured products on their own and the Appellant has merely purchased goods manufactured by contract manufacturers.

[41] Dr. Kanag-Isvaran's submission was that the Appellant only provided specifications, moulds and colours or ingredients to be added on, in order to differentiate the shape of the products which are the usual practices in any field of business. Dr. Kanag-Isvaran however, argued that such practices cannot be construed to classify the Appellant as the manufacturer. He further submitted that RMCC and PSL are contract manufacturers, and a contract manufacturer is in law regarded as the manufacturer. His contention was that in the absence of any statutory provision, the concept of a deemed manufacturer cannot be applied in respect of the supply of goods.

[42] His second argument was that the Appellant has paid VAT on the supplies made by the contract manufacturers but the Appellant did not claim an input credit in respect of such purchases or charged VAT for persons to whom it had

sold these goods since it is only engaged in the activity of buying from the contract manufacturers. He contended that the Appellant has not claimed input tax credit in respect of such purchases and thus, it has not charged VAT for persons to whom it has sold goods. He further submitted that RMCC and PSL are registered with the Inland Revenue Department as manufacturers for VAT purposes, and issued VAT invoices in respect of the present transaction indicating that they have made supplies of goods. His third argument was that the Appellant is only engaged in buying and selling products manufactured by the RMCC and PSL, and therefore, the Appellant does not fall within the statutory definition of a "manufacturer" for the purposes of the VAT Act.

[43] On the other hand, the learned Senior Additional Solicitor General submitted that the wholesale and retail supply of goods is carried out by a manufacturer or importer are subject to VAT. She submitted, however, that the different acts which are covered under the definition of "manufacture" do not necessarily coincide with the person who is deemed to be the manufacturer for the purposes of the VAT Act.

[44] Her submission was that the Appellant is engaged in the exploitation of intangible property as a sole and only licensee of Unilever, in terms of Article 3 of the Trade Mark Agreement in connection with the manufacture, packing, advertising and sale of Unilever products. She further submitted that the exploitation of intangible property is a taxable activity as defined in section 83 of the VAT Act. Her contention was that in terms of section 3 of the Trade Mark Agreement, the Appellant cannot sub license the trademarks, but can only exploit intangible property, exclusively and therefore, the supplies made by the Appellant are taxable supplies within the meaning of section 83 of the VAT Act.

[45] She further submitted that despite the fact that the Appellant was not physically engaged in the manufacture of the products, and the manufacturing takes place in the premises of RMCC and PSL using their raw materials, the degree of control vested in the Appellant throughout the manufacturing process, unequivocally established that it is the manufacturer. Her contention was that the RMCC and PSL are only providing contract services to the Appellant and the manufacturing of goods had been done by RMCC and PSL subject to full control and supervision of the Appellant.

[46] She specifically drew our attention to the articles of the agreements which deal with the involvement of the Appellant in connection with the product

manufacturing activities done by RMCC and PSL and submitted that they were under direct supervision, direction and control of the Appellant. Accordingly, she argued that the Appellant who carried out manufacturing activities is directing involved in the manufacturing activities defined in section 83 and therefore, the Appellant is the actual manufacturer of goods bearing the Appellant's trademarks.

Statutory provisions

[47] Before embarking upon the rival contentions of the parties, I may proceed to consider the relevant statutory provisions which have a bearing on the issue. The scope for the imposition of VAT is provided for in section 2 of the VAT Act. Section 2 of the VAT Act provides that, subject to the provisions of the VAT Act, the Value Added Tax (VAT) 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 the carrying on, or, or carrying out, of a **taxable activity** by such person in Sri Lanka;*

(b) on the importation of goods into Sri Lanka, by any person, and on the value of such goods or services supplied or the goods imported, as the case may be subject to the provision of section 2A, at the rates more fully specified in the said section.

[48] In terms of section 2 of the VAT Act, in order to render the relevant supply of goods and services liable to VAT, the said supply has to be a taxable supply of goods or services made by a registered person and made in the course of carrying out a taxable activity. The terms "supply of goods", "taxable supply" and "taxable supply", "taxable activity" are defined in section 83 of the VAT Act.

"Supply of goods" means the passing of exclusive ownership of goods to another as the owner of such goods or under the authority of any written law and includes the sale of goods by public auction, the transfer of goods under a hire purchase agreement, the sale of goods in satisfaction of a debt and the transfer of goods from a taxable activity to a non-taxable activity".

"Supply of services" means any supply which a supply of goods, but includes any loss incurred in a taxable activity for which an indemnity is due".

"taxable supply" means any supply of goods or services made or deemed to be made in Sri Lanka which is chargeable with tax under this Act and

includes a supply charged at the rate of zero percent other than an exempt supply".

"taxable activity" means-

(a) Any activity carried on as a business, trade, profession or vocation other than in the course of employment or every adventure or concern in the nature of a trade;

(b) The provisions of facilities to its members or others for a consideration and the payment of subscription in the case of a club, association or organization;

(c) Anything done in connection with the commencement or cessation of any activity or provision or facilities referred to in (a) or (b);

(d) The hiring or leasing of any movable property or the administration of any property;

(e) The exploitation of any intangible property such as patents, copyrights or other similar assets where such asset is registered in Sri Lanka or the owner of such asset is domiciled in Sri Lanka".

Exemption of wholesale and retail supply of goods

[49] The imposition of VAT is, arrived at after taking into account the various exemptions and deductions allowed under the provisions of the VAT Act. In terms of section 3 of the VAT Act. Section 3 of the VAT Act sets out the exceptions to the imposition of VAT specified in section 2 and provides that the wholesale and retail supply of goods are exempted from the VAT unless the said wholesale or retail supply of goods is carried out by a manufacturer or importer of such goods. Section 3 reads *inter alia*, as follows:

"Notwithstanding the provisions of section 2, the tax shall not be charged on the wholesale or retail supply of goods, other than on the wholesale or retail supply of goods, by

(a) a manufacturer of such goods; or

(b) ....

[50] It is clear that the intention of the legislature is to provide the benefit to a person who is engaged in the wholesale or retail supply of goods, and not to a manufacturer who is engaged in the wholesale and retail supply of goods. The main reason for which the Assessor disallowed the exemption sought by the Appellant was that the Appellant was, in terms of the articles of the agreements, is the manufacturer of the products in question.

[51] Now the question whether the supply of Vim dish wash bars and Signal tooth brushes is a taxable supply made in the course of the carrying out, of a taxable activity by the Appellant depends on the answer to the question whether or not the Appellant is the "manufacturer" within the meaning of section 3(1)(a) of the VAT Act.

[52] The Appellant's case is that the Appellant is not the manufacturer of the goods in question as it is not engaged in or participated in the manufacturing activities detailed in the definition of "manufacture" in section 83. Thus, the Appellant's contention is that that though it is in the business of wholesale/retail supply of goods as a non-manufacturer, and purchased the goods, the real manufacturer is RMCC and PSL who manufactured the products using their raw materials, labor and facilities.

[53] The VAT Act defines the term "manufacture" in section 83 of the VAT Act as follows:

> *"Making of any article, the assembling or joining of an article by whatever process, adapting for sale any article, packaging, bottling, putting into boxes, cutting, cleaning, polishing, wrapping, labelling or in any other way preparing an article **for sale** other than in a wholesale or retail activity".*

[54] The Appellant strongly relies on the word "means" used in the definition of "manufacture" and argues that it is an exhaustive definition and therefore, it is restricted to the activities detailed in the definition of "manufacture" in section 83 of the VAT Act. In summary, the Appellant's argument is that where the word "means" is used, the meaning of the word has been restricted to the activities detailed in the definition and therefore, no other meaning can be assigned to the expression than is put down.

[55] It is my opinion, that a mere process or activity using labour, facility and substance (i.e. raw material) will not tantamount to manufacture as defined in section 83, unless there is a transformation of numerous processes defined in section 83, into a new substance (finished product) **for sale** with certain identifiable characteristics. The definition of "manufacture" in section 83 makes it very clear that it is used to mean any such manufacturing process or activity which transforms the substance into a new substance (finished product) **for sale** with certain identifiable characteristics known to the market. The Indian Supreme Court in *Union of India v. New Delhi Cloth & General Mills Co. Ltd.* AIR (1963) SC 791, held in paragraph 11 that:

"The word "manufacture" used as a verb is generally understood to mean as "bringing into existence a new substance" and does not mean merely "to produce some change in a substance", however minor in consequence the change may be. This distinction is well brought about in a passage thus quoted in Permanent Edition of Words and Phrases, Vol. 26, from an American judgment. The passage runs thus:-

'Manufacture' implies a change, but every change is not manufacture and yet every change of an article is the result of treatment, labour and manipulation. But something more is necessary and there must be transformation; a new and different article must emerge having a distinctive name, character or use."

[56] From the wording of section 83, it is clear that a manufacture is a process of transforming or turning any substance (i.e. raw material) or part thereof into a new substance (finished product) for sale having a distinctive character, name, and quality through the activities defined in section 83. The VAT Act, however, does not define the term "manufacturer". The Appellant, however, argues that based on the definition of the term "manufacture" in section 83, a manufacturer should be considered as a person who is engaged in the manufacturing activities defined in section 83 and no other meaning can be assigned to a manufacturer.

[57] The argument of the learned Senior Additional Solicitor General is, however, that the VAT Act does not describe what physical acts would amount to "manufacture". She argued that the definition of "taxable activity" in section 83 sets out five different activities and the Appellant's activities are captured within the scope of the definition "taxable activity".

[58] Now the first question is whether the manufacturer, for the purposes of the VAT Act can only be a person who is himself engaged in physical activities defined in section 83 of the VAT Act. The second question is whether a person who engages a third party to manufacture goods for and on his behalf, through the activities detailed in section 83, could be regarded as the manufacturer for the purposes of the VAT Act. The answer to this question depends on the substance of the agreement, the nature of the relationship, obligations and involvement of the parties in carrying out the activities defined in section 83 of the VAT Act.

[59] The Appellant strongly relies on the following articles of the agreements to support its contention that it has not undertaken any functions defined in

section 83 of the VAT Act to be regarded as the manufacturer. The Appellant's stand is that it is only engaged in the business of buying and selling, and nothing more.

[60] The relevant parts of the two agreements relied on by the Appellant are as follows:

Agreement between the Appellant and the RMCC

"3.1 RMCC shall manufacture VIM Bar, and other products at the aforesaid premises solely for and as per specification communicated by USK to them from time to time and shall supply the same to USL as per the terms and conditions of this Agreement;

4.3. In accordance with the specifications and quantities communicated by USL, RMCC will on its own arrange to purchase all raw materials, packing material, bags, wrappers, pouches, labels and other inputs for the manufacture of the aforesaid finished products.

4.4. It is specifically clarified that as regards packaging material and the use of aforesaid trademarks, it would be the responsibility of RMCC to arrange to procure wrappers, pouches, bags and other packing material in full conformity with the specifications and approved suppliers of UCL for such design, artworks, etc. Before finalizing and using the said packing material for packaging finished products manufactured and sold by them to USL, as per the terms of the agreement.

8.3. RMCC expressly declares and agrees that they shall not claim any right or ownership, or goodwill in any of the trademarks, labels, wrappers, pouches, bags or packages which they use or apply on the products and/or packaged material used by them in the manufacture of finished products and sold to USL as per this Agreement.

Agreement between the Appellant and PSL

1. *PSL will manufacture, sell and supply Toothbrushes (hereinafter referred to as the product) to USL bearing their brand names as specified and made to their quality specifications and in quantities and as per delivery schedule indicated to PSL from time to time on Purchase Orders issued by USL…*

   The products to be manufactured and supplied by PSL and the technical /quality specifications thereof will be as set in Appendix 2 to this contract, and may be modified/extended as necessary with the mutual consent of the parties.

2. *The Responsibilities of PSL*

2.1.To manufacture and pack the product as per specifications and quality standards set by USL and communicated in writing and updated as necessary from time to time.

2.2.To carry out optimum production planning and resource allocation.

2.3.The accurate transfer of finished goods from PSL's premises to USL Distribution Centre or designated Third Party warehouse, at a minimum daily frequency or as directed by USL".

[61] On the basis of those articles, the Appellant invites us to hold that RMCC and PSL, being contract manufacturers must be held to be the "manufacturer" for the purposes of the VAT Act and that the Appellant is only engaged in buying and selling of goods manufactured by RMCC and PSL. As the parties sought to interpret the term "manufacturer" used in the agreements in a different manner, the Court must first find out the true meaning and the substance of the transaction, and the way in which the Appellant carried on business with RMCC and PSL.

Interpretation of written contracts

[62] When determining the true substance of the relationship between the parties and the characterization of the relationship, it is necessary to consider the proper approach to be adopted in interpreting the true meaning of a written agreement. It is relevant to note that certain rules of interpretation have been formulated with a view to guide the Court in interpreting the true meaning and the substance of any commercial agreement such as the one we are concerned.

General Rule- Textualism

[63] It is settled law that in the true construction of a written agreement between the parties, the general rule is to ascertain what were the mutual intentions of the parties as set out in the contractual words of the agreement. Lord Diplock in *Pioneer Shipping Ltd. and Others Respondents v B.T.P. Tioxide Ltd.*(1982) A.C. H.L, at p. 736 stated:

"The object sought to be achieved in construing any commercial contract is to ascertain what were the mutual intentions of the parties as to the legal obligations each assumed by the contractual words in which they (or brokers acting on their behalf) chose to express them; or, perhaps more accurately, what each would have led the other reasonably to assume were the acts that

he was promising to do or to refrain from doing by the words in which the promises on his part were expressed".

[64] The general rule in interpreting any written agreement or a text is to understand and give full weight to the language used in its grammatical and ordinary sense. This is to give the written agreement or a text, a commercial certainty, and sensible meaning to the language used in its ordinary and grammatical sense. This ordinarily means that the words must prima facie be taken to have been used in their ordinary and grammatical sense. The general rule in construing wills, statutes and written instruments is that the grammatical and ordinary sense of the words is to be adhered to, unless the words would lead to some absurdity, or some repugnance or inconsistency with the rest of the instrument.

[65] In such case, the grammatical and ordinary sense of the words may be modified so as to avoid that absurdity or inconsistency, but no further" [*Grey v. Pearson* (1857) 6 H.L. Cas. 61 at 1060]. Thus, where the words used are free of ambiguity and devoid of commercial absurdity, their natural and ordinary meaning will apply unless the relevant surrounding circumstances demonstrate otherwise [*Bank of Credit and Commerce International SA v. Ali* (2002) 1 AC 251, para 20].

From text to Context - contextualism

[66] There has been a deviation in both statutory and contractual interpretation from a literal approach to a purposive approach, viz, from text to context (see- J. U Spigelman "From Text to Context: Contemporary Contractual Interpretation" (2007) 81 Australian Law Journal 322 www.lawlink.nsw.gov.su/scunder speeches). The case law developments in the English Courts and modified more recently, in *Wood v. Capita Insurance Services Limited* [(2017) UKSC 24] demonstrates that in relation to the interpretation of commercial contracts, textualism and contextualism are not conflicting paradigms, and the extent to which each tool will assist the court in its task, will vary according to the circumstances of the particular agreement. Para 13 states:

"(i) Textualism and contextualism are not conflicting paradigms in a battle for exclusive occupation of the field of contractual interpretation;

(ii) Rather, the lawyer and the judge, when interpreting any contract, can use them as tools to ascertain the objective meaning of the language which the parties have chosen to express their agreement;

(iii) The extent to which each tool will assist the court in its task will vary according to the circumstances of the particular agreement or agreements;

(iv) Some agreements may be successfully interpreted principally by textual analysis, for example, because of their sophistication and complexity and because they have been negotiated and prepared with the assistance of skilled professionals;

(v) The correct interpretation of other contracts may be achieved by a greater emphasis on the factual matrix, for example, because of their informality, brevity or the absence of skilled professional assistance. But negotiators of complex formal contracts may often not achieve a logical and coherent text because of, for example, the conflicting aims of the parties, failures of communication, differing drafting practices, or deadlines which require the parties to compromise in order to reach agreement".

Real Intention of the parties preferred to grammatical sense

[67] The general rule that the grammatical words are presumed to have been used in ordinary sense has been modified in commercial contracts. Commercial contracts must be given a business like interpretation in which the real intention of the parties is to be ascertained with regard to the meaning of particular words used in a written contract. The shift from text to context in commercial contracts on a business line interpretation is clearly reflected in the following statement made by Lord Hoffmann, who reformulated the principles of contractual interpretation in *Investors Compensation Scheme Ltd v. West Bromwich Building Society* (1998) 1 W.L.R. 896. The decision requires the consideration of the whole relevant factual background available to the parties at the time of the contract, as signaling a break with the past:

"The meaning which a document (or any other utterance) would convey to a reasonable man is not the same thing as the meaning of its words. The meaning of words is a matter of dictionaries and grammars, the meaning of the document is what the parties using those words against the relevant background would reasonably have been understood to mean. The background may not merely enable the reasonable man to choose between the possible meanings of words which are ambiguous but even (as occasionally happens in ordinary life) to conclude that the parties must, for whatever reason have used the wrong words or syntax: see Mannai Investments Co. Ltd v. Eagle Star Life Assurance Co. Ltd (1997) A.C. 749)".

[68] If the words used are free of ambiguity and devoid of commercial absurdity, their natural and ordinary meaning will apply unless the relevant surrounding circumstances demonstrate otherwise [*Marble Holdings Ltd v.*

Yatin Development Ltd (2008) 11 HKCFAR 222, para 19]. To ascertain the intention of the parties, the Court reads the terms of the contract **as a whole**, giving the words used their natural and ordinary meaning **in the context of the agreement**, the **parties' relationship**, all the relevant facts **surrounding the transaction so far as known to the parties** [*Bank of Credit and Commerce International SA v. Ali* (2002) 1 A.C. 251, para 8].

[69] In discovering what a reasonable person would have understood the parties to have meant, and whether the labeling of the words are inconsistent with the overall terms of the contract, it is necessary to consider not only the individual words used in the text, but also the **agreement as a whole**, the substance and **object of the contract**, factual and legal background against which the agreement was concluded. Lord Hoffmann in *Jumbo King Ltd v. Faithful Properties Ltd* (1999) 2 HKCFAR 279, 296 identified the proper approach to be adopted in a case such as the present, when identifying the true nature and substance of the agreement in the following passage:

> *"The construction of a document is not a game with words. It is an attempt to discover what a reasonable person would have understood the parties to mean. And this involves having regard not merely to the individual words they have used, but to the agreement as a whole, the factual and legal background against which it was concluded and the practical objects which it was intended to achieve. Quite often this exercise will lead to the conclusion that although there is no reasonable doubt about what the parties meant; they have not expressed themselves very well. Their language may sometimes be careless and they may have said things which, if taken literally, mean something different from what they obviously intended..."*

[70] This legal position was further confirmed recently in the judgment of Lord Numberger of the Supreme Court of the United Kingdom in *The Commissioners for Her Majesty's Revenue and Customs (Respondent) v. Secret Hotels2 Limited (formerly Med Hotels Limited)* [2014] UKSC 16. The Supreme Court considered the question whether a written contract which appears on its face to be intended to govern the relationship between them necessarily falls within a particular legal description or labelling or categorization of a relationship governed by the said written contract.

[71] The Supreme Court held that: (i) when deciding on the categorization of a relationship governed by a written agreement, the label or labels which the parties have used to describe their relationship cannot be conclusive and may often be of little weight; (ii) where the agreement which appears on its face to

be intended to govern the relationship between them, it is necessary to interpret the agreement in order to identify the parties' respective rights and obligations; and (iii) it shall be done in relation to its legal and commercial nature of the relationship unless it is established that it constitutes a sham. Lord Numberger stated in paragraph 32 as follows:

> *"32. When interpreting an agreement, the court must have regard to the words used, to the provisions of the agreement as whole, to the surrounding circumstances in so far as they were known to both parties, and to commercial common sense. When deciding on the categorization of a relationship governed by a written agreement, the label or labels which the parties have used to describe their relationship cannot be conclusive, and may often be of little weight. As Lewison J. said in A1 Lofts Ltd v. Revenue and Customs Commissioners [2010] STC 214, para 40, in a passage cited by Morgan J:*
>
> *"The court is often called upon to decide whether a written contract falls within a particular legal description. In so doing, the court will identify the rights and obligations of the parties as a matter of construction of the written agreement; but it will then go on to consider whether those obligations fall within the relevant legal description. Thus, the question may be whether those rights and obligations are properly characterized as a licence or tenancy (as in Street v. Mountford [1985] AC 809); or as a fixed or floating charge (as in Agnew v. IRC [2001] 2 AC 710), or as a consumer hire agreement (as in TRM Copy Centers (UK) Ltd v. Lanwall Services Ltd [2009] 1 WLR 1375). In all these cases the starting point is to identify the legal rights and obligations of the parties as a matter of contract before going on to classify them."*

[72] Prof. C.G. Weeramantry in his Treatise "Law of Contracts, Vol. II, referring to the local cases states at para 618:

> *"A court of justice in construing a document should have less regard to its letter than to its general sense and intention. This rule constitutes an important modification of the rule discussed in the preceding section. Thus, the court will not consider the mere name given to a transaction, but will rather see what the transaction really is in truth and in fact upon a consideration of all the facts relating to it. The rule that the real intention is to be preferred to the ordinary meaning of words where such intention is clear is the first rule of interpretation laid down by Pothier. Where the intention is clear neither grammar nor punctuation will prevail against it, for the language of Blackstone, neither false English nor bad Latin will destroy a deed. Thus, the courts will not attach overmuch importance to the use in a document of such words as "agent' 'mortgage' or pledge' 'guarantee','kaikili' or 'stridanum' or 'koratuwa', but will examine the transaction in order to determine its true nature. The real intention*

of the parties has similarly prevailed where the property sold was erroneously described, but its identity was clear, and where a transaction was described by the parties as an exchange but was in reality two sales".

[73] It is significant to note that the entire agreement must be looked at, which in turn must be construed against the surrounding factual matrix at the time of its making. In discovering the true intention of the parties what they in fact intended by a particular word used, particular regard must be given to the parties' **underlying commercial aims, importance, objectives, rights and obligations** in entering into the contract, their legal and factual background like a business like interpretation. The High Court of Australia in *Toll (FGCR) Pty Ltd v. Alphapharm Pty Ltd* (2004) 129 CLR 165 at 179 reaffirmed the same principle in the following words:

> *"The meaning of the terms of a contractual document is to be determined by a reasonable person would have understood them to mean. That, normally, requires consideration not only of the text, but also of the surrounding circumstances known to the parties, and the purpose and object of the transaction".*

[74] These principles were most recently restated by the UK Supreme Court in *Arnold v. Britton* [2015] AC 1619, following the previous guidance it had given in *Rainy Sky SA and others v. Kookmin Bank, (2011) UKSC 50)*. In *Arnold v. Britton* (supra), the UK Supreme Court considered the correct approach to be adopted for the interpretation, or construction, of contracts and stated at para 15:

> *"When interpreting a written contract, the court is concerned to identify the intention of the parties by reference to "what a reasonable person having all the background knowledge which would have been available to the parties would have understood them to be using the language in the contract to mean", to quote Lord Hoffmann in Chartbrook Ltd v. Persimmon Homes Ltd [2009] UKHL 3 [2009] 1 AC 1101 , para 14. And it does so by focusing on the meaning of the relevant words, in this case clause 3(2) of each of the 25 leases, in their documentary, factual and commercial context. That meaning has to be assessed in the light of (i) the natural and ordinary meaning of the clause, (ii) any other relevant provisions of the lease, (iii) the overall purpose of the clause and the lease, (iv) the facts and circumstances known or assumed by the parties at the time that the document was executed, and (v) commercial common sense, but (vi) disregarding subjective evidence of any party's intentions".*

[75] In *Wood v. Capita Insurance Services Limited* (supra), which reaffirmed the approach to contract interpretation adopted in *Arnold v. Britton* (supra),

and revisited the balance to be struck between the language used and the commercial context in which a clause was drafted when deciding between competing meanings of a clause. The Supreme Court held, at para 10 that:

> *"The court's task is to ascertain the objective meaning of the language which the parties have chosen to express their agreement. It has long been accepted that this is not a literalist exercise focused solely on a parsing of the wording of the particular clause, but that the court must consider the contract as a whole and, depending on the nature, formality and quality of drafting of the contract, give more or less weight to elements of the wider context in reaching its view as to that objective meaning".*

[76] In P.*T. Weerasinghe v Commissioner General of Inland Revenue*, CA/TAX/0002/2013 decided on 29.07. 2022, the Court of Appeal held:

> *"[49] In interpreting the categorization of a relationship between the parties, it is necessary, first to identify, the parties' respective rights and obligations- the activities to be carried out by the parties in terms of the Agreement, and the real intention and the surrounding circumstances rather than to conclusively rely on the labels which the parties have used to describe their relationship in the Agreement. It must then decide, having regard to those rights and obligations and the surrounding circumstances as a whole, whether the Appellant, can be properly characterized as a "travel agent" or a mere "handling agent".*

[77] In the context, it is the substance of the contract document as a whole has to be taken into consideration, and not merely the form in which a word is used, as there may be different types of contracts that may closely resemble the commercial contracts such as in the present case.

Different types of manufacturing arrangements

[78] Apart from the dispute at hand, the question which arises for our consideration is whether in substance, the said contract was a contract for buying and selling or a contract for a supply of goods or services, or a contract for manufacture and supply, or a contract for mere work and labour.

[79] As major manufacturing companies carry out the manufacturing activity or process, partly or in their own, or partly by outsourcing various activities on job work or by way of licensing or contract manufacturing etc. to save money or labour costs and avoid setting up and maintain manufacturing facilities. There could be various manufacturing arrangements in the manufacturing industry where manufacturing is performed by a full-fledged manufacturer or a licenced manufacturer or a contract manufacturer or a toll manufacturer or

other manufacturing service providers. They are involved in multiple manufacturing, packaging, testing steps at sites, procuring and providing raw materials, semi-finished and intermediate product or finished product, and different types of services including supply of goods ancillary to services in the supply chain.

[80] As various outsourcing activities in the manufacturing industry can take different forms, we have to give a meaningful expression to the term "manufacturer" that falls within the meaning of section 3(1)(a) of the VAT Act having regard to the obligations and activities intended by the parties to be performed in a commercial agreement.

[81] The Appellant submits that the substance of the agreements with RMCC and PSL is one of contract manufacturing in which the contract manufacturer is performing the manufacturing function and thus, the contractual manufacturer is regarded in law as the manufacturer unless there is a statutory deeming provision in law that the party who engages a contract manufacturer is also a manufacturer by operation of law.

Contract Manufacturing Services

[82] A contract manufacturing service is an outsourced arrangement by large companies who hire a contract manufacturer or a manufacturing service provider; (i) to produce goods or provide services for and on their behalf; (ii) increase production capacity or efficient services and get higher profitability and save production/service costs or labour related matters. These outsourcing services are used by large companies who do not have manufacturing facilities on their own or whose facilities to inadequate for large scale production and avoid production or service costs, large facilities and labour matters.

[83] A contractual manufacturer is hired by a large manufacturing company to manufacture goods for and on its behalf, but the principal manufacturer directly bears demand and final customer pricing risk, provided the products made by the contract manufacturer comply with the principal's product and quality specifications and supervision (TP in the manufacturing sector:

Transformation and new challenges, Kaoru Dahm, Richard Sciacca, Juan Sebastian Lleras & Daisuke Hagiwara,

(https://www.internationaltaxreview.com/article/2a699o5qjycho4pib708w/tp-in-the-manufacturing-sector-transformation-and-new-challenges).

[84] The contract manufacturer owns plant and equipment and labour and procures raw materials, according to the standards agreed with the principal manufacturer, and in many instances performs some activities that are ancillary to its licenced or full-fledged manufacturing activities (supra).

[85] In other manufacturing arrangements involve manufacturing services provided by manufacturing service providers who typically manufacture products for other companies using component parts or raw materials, machinery following their design or previously agreed upon specifications. (Identifying Factoryless Goods Producers in the U.S. Statistical System, Jennifer Edgar, Jim Esposito, Brandon Kopp, William Mockovak, Erica Yu. 1 Office of Survey Methods Research, U.S. Bureau of Labor Statistics, p.2). These manufacturing services are common in fields of pharmaceuticals, manufacturing, aerospace, packaging, cosmetics, foods, computers, and so on.

[86] In view of the position taken by the Respondent, that the substance of the agreement's points to the taxable supply of goods by the Appellant and the provision of manufacturing services by RMCC and PSL for and on behalf of the Appellant, it is necessary to consider the substance of the agreements and the activities performed by the parties in the entire manufacturing process.

[87] The VAT Act provides that "supply of services" means any supply which is not a supply of goods, but includes any loss incurred in a taxable activity for which an indemnity is due. In *Robinson v. Graves* (1935) 1 KB 579), in distinguishing a contract for service (work and labour) from a sale of goods, Acton J. stated that where the substance of the contract was that skill and labour should be exercised upon the production of the portrait, and it was only ancillary to that contract that there would pass from the artist to his customer some materials. As those materials were the paint and the canvas, the contract was considered to be one of service (work and labour).

[88] It is apt to reproduce the following statement made by Action J. in *Robinson v. Graves* (supra) at p. 588:

"I treat that judgment as indicating that in the view of Blackburn J. one has to look to the substance of the contract. If you find, as they did in Lee v. Griffin, 1 B. & S. 272; 30 L. J. (Q. B.) 252 that the substance of the contract was the production of something to be sold by the dentist to the dentist's customer, then that is a sale of goods. But if the substance of the contract, on the other hand, is that skill and labour have to be exercised for the production of the article and that it is only ancillary to that that there will pass from the artist to his client or customer some materials in addition to the skill involved in the production of the portrait, that does not make any difference to the result, because the substance of the contract is the skill and experience of the artist in producing the picture".

[89] On the basis of this test, a contract with a professional person such as a lawyer or an accountant is a contract for services even though documents may be prepared and passed to the client so as to become his property (see- P.S. Atiyak, John N. Adams & Hector Marcqueen, The Sale of Goods, 11th Ed. P. 27). As illustrated by Acton j. in *Robinson v Graves* (supra), the test for deciding whether a contract falls into the one category or another is to ask what is the 'substance' of the contract. (*Robinson v. Graves* (1935) 1 KB 579).

[90] Section 2(1) of the Sale of Goods Ordinance, (Chapter 84) defines a contract of sale of goods as:

> *"A contract of sale of goods is a contract whereby the seller transfers or agrees to transfer the property in goods to the buyer for a money consideration, called "the price". There may be a contract of sale between one part-owner and another".*

[91] Section (2) and (3) give different names to two transactions:

> *(2) A contract of sale may be absolute or conditional.*
>
> *(3) Where under a contract of sale, the property in the goods is transferred from the seller to the buyer, the contract is called "a sale", but where the transfer of the property in the goods is to take place at a future time, or subject to some condition thereafter to be fulfilled, the contract is called "an agreement to sell".*

[92] Accordingly, a contract for the sale of goods may be distinguished from a number of transactions that may not fall within the ambit of the sale of goods. If the real substance of the contract is the ultimate result- the goods to be provided for sale to the buyer for a consideration, the contract is one of sale of goods (P.S. Atiyah, John Adams & Hector MacQueen, The Sale of Goods, 11th Ed. P.27).

[93] If the substance of the contract is that skill and labour of the supplier have to be exercised in the production of the article and the passage of goods is only ancillary, it is a contract for the supply of services. In such case, the substance of the contract is the skill and labour in producing the articles in question.

[94] Addison on Contracts, 11th ed., p. 867, states that "In the case of works of art, the work and skill of the workman constitute, in general, the essence of the contract, the materials being merely accessorial; and, whenever the skill and labour are of the highest description, and the materials of small comparative value, the contract is a contract for work, labour and materials, and not a contract of sale." If work and labour constitute the essence of the contract that is decisive, then the contract is not one for the sale of goods but a contract for work and labour (service).

[95] If the substance of the contract involves the supply of goods and the supply of services by several persons in the execution of the contractual obligations, it is necessary to identify the predominant and the ancillary elements of supplies, and determine who is engaged in the supply of goods and the supply of services forming part of a taxable activity. The answer to this question will determine as to who can be considered as the manufacturer, or who can be considered as the service provider to the manufacturing activities defined in section 83 of the VAT Act.

[96] The Appellant submits that the concept of deemed manufacturer is not statutorily recognized in the VAT Act and therefore, the Appellant cannot be regarded as a deemed manufacturer unless there is a statutory deeming provision in law that provides that the party who engages a contract manufacturer is the manufacturer by operation of law. The concept of deemed manufacture arises where the activity which is not a "manufacture" in law, but has deliberately included in the definition of manufacture in any statute. The concept applies where a person who has never undertaken any manufacturing activity by himself or through others and never involved in any activity of manufacture of any finished goods, but is treated as a deemed manufacturer as per a special definition of a statute.

[97] In the present case, the term "manufacture" is defined in section 83 of the VAT Act, which covers the process of manufacture of products in question and therefore, the question for decision is not whether the Appellant is a "deemed manufacturer" but is the real manufacturer of the goods through the effective

involvement of any manufacturing activities defined in section 83 of the VAT Act.

[98] In such event, the question as to who can be regarded as the real manufacturer for the purposes of section 3(1)(a) of the VAT Act, must be decided on the examination of the substance of the contract, the rights and obligations set out therein, and the intentions of the parties who entered into the agreements rather than merely going by the words such as "manufacture", "sale", "supply" or "delivery" used in the contract.

[99] I shall now consider the conditions and activities and obligations of the Appellant and RMCC/PSL when they entered into the agreements in question for the court to determine the real manufacturer of the products in question within the meaning of section 3(1)(a) of the VAT Act.

Trademark license Agreement entered into between Unilever PLC, UK and Unilever Ceylon Ltd (Appellant)

[100] Unilever PLC, UK is the owner of internationally well-known trade marks on a variety of goods, which are manufactured and marketed worldwide. In terms of the said Trademark Licence Agreement, the Appellant had been licensed to manufacture, sell the products in Sri Lanka and export products to Maldives listed in Schedule "A" to the agreement. (p 45 of the TAC brief). The recital to the Agreement states as follows:

> *"Licensee wishes to* ***manufacture and/or sell the products in Sri Lanka and export the products to the Maldives*** *in respect of all those products listed in Schedule "A" hereto".*

[101] In terms of the agreement, the Appellant as the sole and only licensee has rights to use the Unilever trademarks and manufacture, package, advertise and sell the products using its trademarks on an industrial scale and report to Unilever in the annual report such manufacturing, packaging, advertising and selling activities. The scope of the agreement is stated in the agreement as follows:

> *"Subject to the Terms and Conditions set forth in this agreement, Licensor hereby grants to licensee a non-exclusive license to use and apply the intellectual property rights, including the trademark on or in relation to the products, in the territory for the duration of this agreement.*

Licensee agrees to use the trademarks on the products in the territory on an industrial scale and to furnish an industrial scale and to furnish Lisensor with an annual reporting relating thereto…".

[102] In terms of Article 3 of the agreement, the Appellant as the licensee cannot sub-license or sub-contract the trade marks (p. 139 of the TAC brief). It reads as follows:

"Licensee may not sublicense the trademarks".

[103] Article 4 of the agreement sets out the manner in which the products shall be manufactured by the Appellant using the Unilever formulae, specifications and other instructions provided by Unilever PLC, UK as follows:

4.1 The products shall be manufactured in accordance with the formulae, specifications and other instructions provided by Licensor*;*

4.2. Licensee shall at all times permit Licensor or its authorized representations to enter the premises of Licensee to inspect the products and physical manufacturing and storage facilities used by the Licensee or under its directions in order to ascertain whether the products meet the specifications, nature and quality laid down by Licensor of the products and the packaging covered by the Trade Marks….; [p. 139 of the TAC brief]

Quality and quality control

[104] The agreement has laid down conditions for the use of Unilever trademarks by the Appellant and provides that the products shall be manufactured according to the quality control guidance, specifications and directions provided by Unilever PLC, UK (p. 45 of the TCA brief). It reads:

"Licensor shall use all reasonable endeavors to give the licensee guidance in achieving a quality and appearance of the products which are equivalent to the quality of corresponding products manufactured by Group of Companies;

Licensee shall agree and achieve quality and appearance standards for the manufacture of their products, which is no case shall be less than the minimum prescribed by the licensor for such, or in accordance with the above clauses and shall only use the trademarks for the sale of the products. If as a consequence of any applicable legal provision's licensee is not able to comply with the formulae, specifications and directions provided by the licensor, licensee shall inform licensor forthwith and the parties shall discuss and agree the consequences".

[105] Article 12.1 of the agreement provides that all right, title and interest in or to the trademarks and related goods shall remain the exclusive property of Licensor. It reads as follows:

> *"12.1 Nothing in this agreement shall be construed as an assignment or grant to Licensee of any proprietary right, title or interest in or to the Trademarks and its related goodwill and it is specifically understood and acknowledged by Licensee that all right, title and interest in or to the Trade Marks and related goodwill are reserved by and are shall at all times remain the exclusive property of Licensor".*

[106] From the aforesaid agreement, the Appellant as the sole and exclusive license to manufacture, package, advertise and sell Unilever Products using its trademarks, and export to the Maldives to the exclusion of all subject to the terms and conditions stipulated in the said agreement. It is manifest that in terms of the Trade Marks Licence Agreement, it is only the Appellant who has the right to use the trademarks of Unilever (Signal and VIM and manufacture, tooth brushes under the name of Signal and manufacture Vim dish wash bars under the name of VIM and sell the said products bearing the Unilever trademarks.

[107] No other person could have claimed to be the manufacturer of such products and claim title, right, and interest to such products using the trademarks of Unilever. It is further manifest that in terms of the said Trade Marks License Agreement, all right, title and interest in the trademarks shall remain the exclusive property of Unilever and the Appellant can only manufacture, package, advertise and sell and export such products using the trademarks subject to the terms and conditions and in accordance with the formulae, specifications and other instructions provided by Unilever PLC, UK.

[108] It is now necessary to consider the obligations and activities of the Appellant and RMCC/PSL as specified in the agreements between the Appellant and RMCC/PSL, to determine whether it is the Appellant who is effectively and deeply involved in the manufacturing activities defined in section 83 of the VAT Act, or whether the discretion of the manufacturing activities defined in section 83 of the VAT Act was entirely left with RMCC and PSL to exercise their skill and judgment to produce the completed products for sale.

Agreement between the Appellant and RMCC in respect of the manufacture of Vim Scourer Bars bearing the Unilever's VIM trade mark

[109] I shall now proceed to consider the agreements between the Appellant and RMCC. The scope of the agreement between the Appellant and RMCC is set out in Article 3, which provides that RMCC shall manufacture Vim scourer bars and other products at its premises solely for and as per the specifications provided by the Appellant and supply such products **exclusively t**o the Appellant. Article 3 reads as follows:

> *3.1 RMCC shall manufacture VIM Bar and other products at the aforesaid premises solely for and as per specifications by USL to them from time to time and shall supply the same to USL as per the terms and conditions of this Agreement.*

[110] The Appellant has permitted RMCC to use the Unilever trademarks in connection with the VIM bar products and other articles manufactured by RMCC, However, RMCC cannot enter into any agreement with any party and supply the same to any other party. Article 3 reads as follows:

> *"3.2 USL on its part has represented and confirmed that the said brand name VIM belongs to UNILEVER SRI LANKA USL has accordingly, permitted RMCC to use on or in connection with VIM Bar to be manufactured by them in pursuance to this Agreement and/or on all cartons, wrappers, pouches and other packing materials used or to be used for packing finished product so manufactured by RMCC*
>
> *3.3. RMCC shall not enter into agreements with other parties/for the supply of product out of the aforesaid premises and plant without the consent of USL".*

Involvement of the Appellant over the manufacturing activities & control over the manufacturing process/activities

[111] In terms of the agreement, RMCC however, cannot manufacture products using the Appellant's trademarks, exercising its sole and exclusive judgment and control as it was obliged to manufacture the products strictly in accordance with formulations and specifications, examinations, inspections and instructions provided by the Appellant. It was the Appellant who laid down specifications, decided the raw materials and the quantity, quality, and carried out the examinations, inspections and quality control tests of products according its instructions, rules and regulations laid down by Unilever PLC, UK.

[112] As set out in Article 5, the Appellant is effectively and deeply involved in the manufacturing activities of RMCC by controlling, inspecting, examining and supervising the entire manufacturing activities. It further includes the selection

of raw materials, managing the quality control system and rejecting any finished product which is not in conformity with its specifications. Article 5 reads as follows:

"5.1. It will be the responsibility of RMCC to manufacture and produce the said products strictly in accordance with formulations and specifications communicated by USL. USL, on its part, will be entitled to carry out examination, inspection and quality control tests of products so produced and manufactured by RMCC in order to test their compliance with quality specifications of the USL;

5.2.USL will be entitled to reject such finished products, which are not in conformity with quality specifications of the USL and the USL's word shall be final and binding in this respect;

5.3. RMCC however, will be free to reprocess the rejected finished products at its own cost and take steps, if possible, to bring them into total conformity with quality specifications and thereafter, they may be accepted by USL and sold as per this Agreement. For the aforesaid purpose, RMCC will permit USL representative to be present at the said premises and provide all necessary equipment and facilitate quality checks, etc.;

5.4 RMCC will continuously co-operate with USL to upgrade, improve and enhance its quality control procedures. Any increase in cost to be mutually agreed upon;

5.5. RMCC shall keep records of its quality control and the date shall be readily accessible to the USL;

5.6 Quality assurance of finished goods will be done by USL personnel at the site and transferred daily to the warehouse;

5.7. RMCC will implement all reasonable regulations resulting from quality and audits conducted by USL".

s

[113] As set out in Articles 8.3 and 8.4 of the Agreement, RMCC has no claim whatsoever to any right or ownership, or goodwill in any of the trademarks, labels, wrappers, pouches, bags or packages which RMCC apply to the products and sold to the Appellant. Article 8.3 reads as follows:

"8.3. RMCC expressly declares and agrees that they shall not claim any right or ownership in any of the trademarks, labels, wrappers, pouches, bags or packages which they use or apply on the products and/or packaged material used by them in the manufacture of finished products and sales to the USL;

8.4. RMCC further undertakes that they shall not infringe, copy or imitate or otherwise interfere with the brand name, trade and merchandise marks of *devices or licenses or copyright as they may be authorized to use by these presents or otherwise alter, deface or interfere with the same or describe them as that of USL or as having been manufactured for USL or any of its associate companies. It is further clarified that RMCC shall have no authority to permit, use or cause to be used the aforesaid trademarks, labels, wrappers, pouches, bags or packing material by any other person or by themselves or in relation to products not manufactured or produced for USL".*

Agreement between the Appellant and PSL in respect of manufacture of tooth brushes bearing the brand name of "Signal"

[114] The scope of the agreement between the Appellant and PSL is set out in Article 1. It provides that PSL will manufacture, sell and supply toothbrushes to the Appellant bearing licensed Unilever brand names as specified and subject to the quality specifications and in quantities, and as per delivery schedules indicated to PSL from time to time on purchase orders issued by USL. It reads:

1. PSL will manufacture, sell and supply Toothbrushes (hereinafter referred to as the product) to USL bearing their brand names as specified and made to their quality specifications and quantities and as per delivery schedules indicated to PSL from time to time on Purchase Orders issued by USL;

Involvement of the Appellant over the manufacturing activities & Control of the manufacturing process/activities

[115] PSL however, cannot manufacture products using the Appellant's trademarks exercising its sole and exclusive judgment and full control as it was obliged to manufacture the products strictly in accordance with formulations, specifications, examinations and instructions provided by the Appellant. It was the Appellant who carried out the examinations, inspections and quality control tests according to its own instructions.

[116] As set out in the following Articles of the agreement, the Appellant is effectively and deeply involved in the manufacturing activities of PSL. The Appellant's activities involve the control, inspection, examination and supervision of the entire manufacturing activities, managing the quality control system and rejecting any finished product which is not in conformity with its specifications. Article 3 reads:

3.1 ***USL will provide written specifications, quality acceptance criteria and inspection methodology to PSL in respect of each product under this agreement;***

3.2 ***USL will provide all plastics moulding tools necessary, at its own cost and these tools will remain USL's exclusive property. However, PSL will assist in sourcing these moulding tools from its preferred sources as necessary;***

3.3. ***Insurance cover for the moulding tools will be taken by USL;***

3.4 USL will provide three months forward forecast of its requirement of each product for PSL to plan material procurement and production. USL will also provide an annual forecast for PSL to review capacity needs.

4.Quality Control

The products manufactured and packed will be the quality specifications as laid down by USL in Appendix 3;

4.1 *Quality Assurance of finished product is the responsibility of PSL and will conform to USL's specifications, quality criteria and inspection methodology stipulated in Annexes 3*

4.2. PSL will continuously co-operate with USL to upgrade, improve and enhance its quality control procedures

4.3. PSL shall keep records of its quality control and the data shall be readily accessible to USL;

4.4. Quality auditing of finished goods as deemed necessary will be done by USL designated personnel at site, and due access should be provided to USL personnel for this purpose;

4.5.PSL shall implement all reasonable regulatory/remedial measures as necessary arising out of quality audits conducted by USL;

4.6. All products will be manufactured to meet the quality safety criteria specified in relevant contract elements;

4.7.USL shall do quality checks on products delivered to it and is not liable for products not meeting quality norms;
4.8. Any products not meeting standards will be destroyed by PSL at their cost.

7.Termination

7.3 PSL shall at the termination or sooner determination of the agreement will hand over the following to USL:

-All plastics moulding tools owned by USL;

-Any finished e work in progress at the time of termination

9.3. *PSL warrants that the product/products manufactured by it will conform to the specifications and quality standards provided by USL.....*

9.8. *PSL shall pack the products on the format and type as approved by USL. The "PRODUCT" shall be sold or promoted by USL under trademark/brand name specified….*

PSL will give a guarantee to USL that during the course of the Agreement or thereafter that he will not use identical specifications given by USL from time to time for the manufacture of toothbrushes under any brand name".

[117] As set out in Article 8 and 9, PSL expressly declared and agreed that it has no claim whatsoever to any right or ownership, or goodwill in any of the trademarks owned by the Appellant. The PSL has further agreed that it shall not claim any right or ownership in any of the trademarks/brand names in the products labels, wrappers, pouches, bags or packages which they use or apply on the products sold to the Appellant. It reads:

"8.3. Any intellectual property rights in and to the information, generated and provided by the disclosing party to the receiving party, shall remain owned by the disclosing party and any intellectual property rights in and to developments generated by a party as a result of an action following from the exchange of the information shall be owned by the said party who shall be entitled to protect said developments by any form of intellectual property subject to the provisions of this Agreement.

9.7. PSL shall use his best efforts to preserve and enhance the goodwill of the product and the trademark owned by USL;

9.8. ***PSL shall have no rights under this Agreement to the use of this trade mark/brand name in the product and shall not during the terms of this Agreement or thereafter*** *represent that BPL is the PSL is the owner of the Trademark/brand name whether or not such Trade Mark/brand name is registered nor shall PSL dispute the validity of the Trade Mark/Brand name………..*

PSL shall not at any time manufacture and supply the product for sale either by himself or by any third party during the term of this Agreement. *PSL shall not at any time register or cause to be registered in its name or in the name of another who is so employed during or after the term of this Agreement, any of the Trademarks or Trade Mark names or designs resembling or similar to any of the Trade Marks of USL. PSL agrees that upon the termination of this Agreement, it will discontinue forthwith all use of such Trademarks and Trade Names and shall not thereafter directly or indirectly manufacture and pack any products bearing the Trade Mark names confusingly similar to the Trade Mark of USL".*

[118] From the obligations and activities set out in both agreements, it is manifest that the Appellant being the licensed manufacturer and trademark licensee had outsourced the manufacturing process to RMCC and PSL and engaged both RMCC and PSL to manufacture goods exclusively for and on its behalf, using its trademarks, and supply such branded goods to the Appellant. Accordingly, the taxable activity will be treated as a supply of goods for VAT purposes.

[119] Now the question as to whether the Appellant could be considered as the manufacturer, would depend on the question whether the Appellant was engaged in supplying goods in the course of taxable activity for the purposes of the VAT Act. The answer to this question depends on the consideration of activities performed by the Appellant in the manufacturing process, and its effective and deep involvement and control in the manufacturing process for making a finished product.

[120] The Indian Supreme Court in *Chillies Exports House Limited v. Commissioner of Income Tax*, 225 ITR 814 held in paragraph 8 that the question whether the assassin was carrying on process of goods has to be looked at by taking into consideration the different activities carried out by the assessee and their cumulative effect on the value of the manufacturing or processing of goods.

[121] The learned Senior Additional Solicitor General submitted that the goods were manufactured by RMCC and PSL under the Appellant's sole control and supervision using the moulds provided by the Appellant, formulations and specifications and accordingly, the TAC was justified in holding that the Appellant is engaged in the manufacturing activity as the manufacturer.

Effective Control test

[122] A survey of various judicial authorities indicates that the question as to whether the assessee is the manufacturer, has to be determined in the context of the control exercised by the assessee over the manufacturing activities and his effective and deep involvement in the manufacturing activities.

[123] The Supreme Court of India held in *Commissioner of Sales Tax, U.P v Dr. Sukh Deo* (1969) 23 STC 385 (SC) / 1969 AIR 499 that a manufacturer is a person by whom or under whose direction or control the goods are manufactured. In the High Court of Madras case of *Commissioner of Income*

Tax v. Elgi Ultra Industries Limited (TS-658-HC-2012 (MAD) -01, even though the process of assembling of raw materials was done through two job workers, the manufacturing activity starting from planning, development of the model, procuring of raw materials, inspections and testing, quality control activities were done by the assessee. The High Court applied the control test and held that the question as to whether the assessee is engaged in the manufacturing process or not, has to be seen in the context of the control exercised by the assessee, even in the case of assembling was done by a third party. The High Court stated at paragraph 8:

> *"The order of the authorities below shows that the assessee exercised supervision and control in the manufacturing of the parts done by the job workers on the materials supplied by the assessee in accordance with the specification in the dyes supplied by the assessee. They were subject to quality control too. Thus, even though the assessee had not employed its own employees, yet, the fact is that at every stage the assessee had extracted control over the* job work as though they were employees of the assessee…"

[124] The Kerala High Court in *Commissioner of Income-Tax v. Rajmohan Cashews* (P.) Ltd. [1990]185, ITR472 (Ker) held that when the assessee company was engaged in processing raw cashew nuts and the major operation of processing work was done by outside agencies on behalf of the assessee and charges, therefore, we're paid by the assessee. It was held that the assessee was engaged in the manufacture and processing of the goods. The Court held that the processing was not done in the factory of the assessee would not necessarily mean that the assessee is not mainly engaged in the processing of the goods. The Court held that this applies where there is material to show that the processing was done by the outside agency for and on behalf of the assessee, and the charges incurred therefore were paid by the assessee directly.

[125] The High Court of Allahabad in *Bulbu Prasad Amarnath v. Commissioner of Sales Tax,* (1964) 15 STC 46, it was held that it is not merely the person who manufactures, but even the person who had the goods manufactured who would be a manufacturer. It stated:

> *"5. In order that a person is a manufacturer of linseed oil it is not essential that he should himself produce oil from oilseeds or should produce it with his own machinery or should produce it in his own premises. He can be a*

manufacturer if what he gets done through others is deemed to be his act, and the act amounts to manufacturing…………

9. This makes it clear that the assessee is the manufacturer though it only caused oil to be produced instead of producing it itself. In determining whether or not a person is a manufacturer the Court first ascertains what his business consists in and then whether or not that business is manufactured. And everyone who manufactures is not a manufacturer; the manufacture may be merely incidental to another business; thus, a farmer who makes articles from his produce undoubtedly manufactures them, but is not a manufacturer because his business is to produce the raw material and the manufacture is not in his case a business by itself but only an incident to his farming".

[126] In the Bombay High Court in *Commissioner of Income-Tax v. Penwalt India Ltd,* [TS-5495-HC-1991 (Bombay) -OJ, the manufacturing process was carried out under the direct supervision of the assessee, and one Turner Hoare manufactured machinery as per the instructions of the assessee. The Revenue, admitted that (i) it was not necessary for a person to be engaged in a manufacturing activity, that he should undertake all manufacturing activities by himself; (ii) it would be enough if he engages himself in part in the manufacturing activity and gets the rest of it done through the agency of others. The Revenue, however, contended that no part of the manufacturing activity was done by the assessee as everything concerning was done by Turner Hoare.

[127] The High Court rejected the argument of the Revenue and held that the expression "engaged in manufacture" does not indicate that the assessee should be directly involved in the manufacturing process and that it will include cases where he gets the goods manufactured totally by an outside agency. The High Court found that, out of many activities, except for one activity, namely getting the machinery manufactured through Turner Hoare, all other activities are admittedly undertaken by the assessee and therefore, the assessee is engaged in the business of manufacture (paragraph 7).

[128] The High refereed to 33, Hulsbury's Laws of England, third edition, "Revenue", paragraph 407, wherein it was said that "*a person is deemed to make goods or to apply a process if the goods are made, or the process is applied, by another person to his order under any form of contract other than a purchase"*. The Court held that at paragraph 6 that:

> *"..an assessee would be said to be engaged in manufacturing activity if he is doing a part if the manufacturing activity by himself and, for the rest of it, engage the services of somebody else on a contract other than a contract of purchase".*

[129] This decision was followed by another Division Bench of the Calcutta High Court in *Griffon Laboratories (P) Ltd v. CIT* (1979) 119 ITR (Cal.) TC 24R. 222, wherein it has been held that a manufacturer may hire a plant or machinery and hired labour to manufacture the goods. But to earn the benefit of the of the concessional rate of tax as an industrial company, the company must mainly engage itself in the manufacture or processing of goods as specified in section 2 (7) of the Finance Act, 1996, either by itself or by someone under its supervisory control or direction.

[130] Although some Indian cases were decided under the Finance Act, 1996, IT Act, 1961 of India and the Sales Act, the fundamental issue that arose in all those cases was whether activity carried out by the assessee was engaged in the manufacturing process or carrying on a manufacturing activity, which resulted in making the goods. The Courts held that the question as to whether the assessee is engaged in the manufacturing process, or not has to be seen in the context of the control exercised by the assessee.

[131] The mere use of the word "manufacturer" in any of the manufacturing contract, whether it is licensed manufacturing, or contract manufacturing or toll manufacturing or manufacturing service provider is not the criterion to determine the question of manufacturer who is entitled to the benefit of the exemption under section 3(1)(a) of the VAT Act.

[132] The test for deciding whether the taxpayer is the "manufacturer" for the purposes of section 3(1)(a) of the VAT Act is to ask whether the taxpayer is effectively and deeply involved in the process of manufacture defined in section 83, and exercised direct control and supervision over the manufacturing process to produce the completed new product having a distinctive character, quality, name and use for sale.

[133] From the facts detailed above, it is obvious that the Appellant obtained the licence from Unilever U.K as the sole licensee for manufacturing, selling, supplying and exporting Signal toothbrushes and Vim sourer bar using trademarks on non-transferable basis, and paying royalty to Unilever U.K. No other person except the Appellant is entitled to manufacture, advertise,

market, distribute and sell the Unilever products bearing its trademarks and brand names both for local and export market without the written permission of Unilever PLC, UK.

[134] Apart from procurement of components of raw materials and the assembly of raw materials was done through PSL using its facilities, the agreement between the Appellant and PSL manifestly indicate that the Appellant's effective and deep involvement in the manufacturing activities. These activities consist of:

(i) supply of the Appellant's moulds exclusively to manufacture the product at its own cost and the moulds remain on the Appellant's exclusive property;
(ii) Undertaking all major repairs for moulds used in the production and bearing responsibility for insurance cover for moulding tools;
(iii) manufacturing the products to be carried out strictly in accordance with the Appellant's formulations, specifications, quantity, supervision and instruction;
(iv) managing and conducting the quality control tests at all levels;
(v) quality auditing of finished goods to be done at the site by assigned employees of the Appellant;
(vi) supply of products to be done as per the delivery schedule advised by the Appellant;
(vii) upgrading, improving and enhancing of quality control for product development and efficiency; and
(viii) rejection of finished products which are not in conformity of the quality specifications; and
(ix) accessibility to records of the quality control and data.

[135] Apart from procurement of components of raw materials and the assembly of raw materials was done through labour contractors of RMCC using its facilities, the agreement between the Appellant and RMCC manifestly indicate that the Appellant's effective and deep involvement in the manufacturing activities. These activities consist of:

(i) manufacturing the products to be done strictly in accordance with the Appellant's formulations, specifications, examinations, quantity, supervision, instructions;

(ii) determining the quantity and supply schedules of the products and selecting the suppliers for design, artworks etc. before finalizing and using the material for packaging finished products;

(iii) managing and conducting the quality control tests of the products at all levels;

(iv) quality auditing of finished goods to be done at the site by assigned employees of the Appellant;

(v) supply of products to be done as per the delivery schedules advised by the Appellant; and

(vi) rejection of finished products which are not in conformity of the quality specifications;

(vii) upgrading, improving and enhancing of quality control procedures; and

(viii) accessibility to records of the quality control and data.

[136] The daily quality control tests were carried out by the Appellant's staff at the site and supply of the finished articles was done according to the formulations, formulations and quality employed by the Appellant. In case any product is found below such specifications and formulations, the Appellant has every right to reject such finished products, not in conformity with quality specifications and such decisions cannot be challenged by RMCC and PSL. In support of its position that the Appellant is not a manufacturer as defined in section 83 of the VAT Act, the Appellant relied on the following statement made by Walpita J. in *Commissioner General of Inland Revenue v Reckitt and Colman of Ceylon Limited* Sri Lanka Tax Cases Vol. IV 362-370L

> *"Counsel for the State also submitted that the change of name from "Seagull Blue" to "Robin Blue", the registered trade name of the assessee, amounted to an adaptation for sale of ultramarine blue imported as "Sea-gull Blue". I am unable to accept this submission, as a mere change of name by itself does not make a product which was originally sold under a different name amount to an "adaptation" for sale within the meaning of the Section and it cannot be so considered in the circumstances of this case.*
>
> *For these reasons, I am of the view that ultramarine blue packaged and sold as "Robin Blue" is not an article "manufactured" by the assessee within the meaning of the term "manufacture" in section 159(1) of Finance Act, No. 11 of 1963".*

[137] In *Revenue v. Reckitt and Colman of Ceylon Limited* (supra), the issue related to the meaning of the term "manufacturer" as defined in section 159(1)

of the Finance Act, No. 11 of 1963. The assessee in that case imported Ultramarine Blue in packets of 58 pounds under the name "Seagull Blue". This was packeted by mechanical and manual process by the assessee into smaller packets under the name "Robin Blue" and sold wholesale. There was no change in the process of packeting. The chemical composition and physical properties were not altered in the process of repacking.

[138] Under such circumstances, the Court held that the assessee is not a manufacturer, nor is there an adaptation of the article as there is no treatment which changes the quality of the product, or makes an unfinished product a finished one. Mere change of name by itself does not amount to adaptation for sale.

[139] It is clear that the assessee who imported finished goods under one name, packeted by mechanical and manual process into smaller packets and sold them under a different name without any change in its composition, quality or character of the finished product. . There was no transformation of the products imported into a different product having a character, quality or composition, and therefore the Court was justified in holding that it was not an article manufactured by the assessee within the meaning of the term "manufacture" in section 159(1) of the Finance Act, No. 11 of 1963. As discussed, the facts of the present case are completely different and therefore, the decision in *Revenue v. Reckitt and Colman of Ceylon Limited* (supra), will not help the Appellant.

[140] Although the plant and machinery employed and raw materials were provided by RMCC and PSL and services of certain employees were also utilized in the manufacturing process, the were manufactured by RMCC and PSL strictly as per the quality, formulations, specifications, quantity prescribed by the Appellant. It is not necessary that the Appellant himself should be personally engaged in the manufacturing of goods by its own plant and machinery at its own factory or pay the wages of the workers, if it is deeply involved in the manufacturing activities defined in section 83 where the Appellant engages a third party for getting the goods manufactured by it under its own effective control and supervision.

[141] In *Griffon Laboratories (P) Ltd v. Commissioner of Income Tax* (supra), the Tribunal held that the assessee was not a manufacturer of goods as it did not own or process any plant or machinery and caused those goods to be manufactured by a third-party company. The High Court held (at paragraph

13) that the "Tribunal erred in holding that the assessee must own or process the manufacturing plant or machinery before it can be said to be a manufacturer of goods". The Court further said that the "Tribunal has not gone into the question as to whether the assessee caused those goods to be manufactured under its actual supervisory control or direction": The ratio of the decision was that the overall control and management of the products manufactured by the third-party company was in the hands of the assessee and accordingly, assessee ought to be held to be the manufacturer of the goods.

[142] In my view, the Appellant need not own or possess the manufacturing plant or machinery or raw materials, or physically involve in the manufacturing process, before it could be said to be a manufacturer of goods provided that he is a person by whom or under whose direction, supervision, control and deep and effective involvement in the manufacturing activity, the goods are made. In the Bombay High Court case of *CIT v. Neo Pharma (P) Ltd. (1982) 28 CTR (B0m.) 223,* it was held that it is not necessary that the manufacturing company must manufacture the goods by its own plant and machinery as its own factory, if, in substance, the manufacturing company has employed another company for getting the goods manufactured by it under its own supervision and control.

[143] The Appellant's exclusive ownership of the finished products is further manifested from the Articles of the two agreements between the Appellant and RMCC/PSL. The agreement between the Appellant and PSL provides that upon the termination of the agreement, PSL shall have no right whatsoever, to keep plastic moulding tools owned by the Appellant (Article 7.3). It further provides that any finished work in progress at the time of termination, shall be handed over to the Appellant (Article 7.3).

[144] In the case of RMCC, the agreement provides that it can own plant and machinery, and dispose of them to any person of their choice (Article 10.3). The agreement provides, however, that RMCC shall discontinue the manufacture and production of products as per formulations and specifications of the Appellant carrying trademarks, wrappers, cld's, pouches, bags, packaging permitted by the Appellant to be used during the operation of the agreement (Article 10.5). Further, RMCC shall hand over all relevant documents to the Appellant (Article 10.5). The agreement further provides that upon termination, RMCC shall sell or hand over all finished products to

the Appellant or dispose of products after duly removing trade name, label, design or copyright used by RMCC on such products (Article 10.8).

[145] In the present case, although the plant and machinery employed for the purpose of manufacture belonged to RMCC and PSL and services of employees were also utilized in that process, all obligations of RMCC and PSL under the agreements were performed under the supervision, control, direction and effective and deep involvement of the Appellant. The manufacturing activity was really that of the Appellant and the Appellant as the licensee to manufacture trademarked goods can be considered as a company engaged in manufacturing of goods for exclusive sale in the local and export market.

[146] The products manufactured were exclusively for the Appellant, and RMCC and PSL were not left with discretion to sell them to any other person. The manufacturing activities were done under the direct control and supervision of the Appellant, which in my view, tantamounted to a manufacturing activity defined in section 83 under the definition of "manufacture".

[147] There is nothing to indicate that the discretion was left with RMCC and PSL to exercise their independent skill and judgment in the manufacturing of products without direction, control and supervision and involvement of the Appellant (see the criterion used by Wright J. in *Cammell Laird & Co. Ltd v. The Manganese Bronze and Brass Co. Ltd*, (1934) A.C. 402 at. 420-421). In my view, the mere making of products by assembling raw materials and using machines, labour and facility by RMCC does not tantamount to manufacture as defined in section 83 of the VAT Act.

[148] I am of the view that a manufacturer is a person by whom or under whose direction or control or manage the goods are manufactured for sale, either by himself or through a third party for its behalf by deeply involved in a manufacturing activity or process defined in section 83 of the VAT Act.

Concept of buying and selling

[149] Now, I will turn to the Appellant's argument that it was only engaged in the business of buying and selling to earn a profit and that the transaction was purely a trading in nature. Buying and selling is an agreement between the buyer and the seller, whereby the seller has the duty to transfer the ownership of property to the buyer and the buyer pays the price of the

property to the seller. But it cannot be said that every purchase made during the course of a business is a business of buying and selling.

Supply of goods, first sale and time of supply

[150] The Appellant contended that RMCC and PSL invoiced goods to the Appellant on a VAT invoice that sets out sales made by RMCC and PSL to the Appellant. The Appellant argued that the ownership passed at the point of sale when the invoices were issued by RMCC and PSL to the Appellant within the meaning of section 4(1) of the VAT Act. The Appellant has produced two invoices said to have been issued by RMCC and PSL to the Appellant with the consolidated written submissions and argued that the said invoices set out the goods manufactured and sold to the Appellant by RMCC and PSL.

[151] It seems that the Appellant relies on section 4(1) of the VAT Act and claims that the supply of goods took place at the point when the invoices were issued by RMCC and PSL to the Appellant and therefore, the Appellant is not liable to VAT liability. VAT is charged on taxable supplies. It is the liability of the person making the supply and becomes due at the time of supply. The VAT is charged and collected by the registered person at the time of supply of taxable goods or services (Balaratnam, VALUE ADDED TAX in Sri Lanka, 2nd Ed. 329). The VAT Act prescribes rules to determine the time at which a supply of goods or services is deemed to take place to ensure that output tax is charged to a customer at the appropriate time and for the registered person to account for the tax in the correct prescribed period (supra).

[152] The role of the time of supply rules in section 4 of the VAT Act is intended to determine the time when the supply of goods or services are to be treated as taking place for the purpose of the charge of tax, which arises at the time of supply in respect of which a taxable supply made by a taxable person and impose the liability to pay the tax under section 2(1) of the VAT Act (Balaratnam, supra, p. 330).

[153] Section 4 (1) of the VAT Act provides that the **supply of goods** shall be deemed to have taken place at the time of the occurrence of any of the following whichever occurs:

(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 for the goods have been effected.

[154] A VAT is not charged on any supply of goods or services made by a person who is not a taxable person, unless there is a taxable supply of goods or services made in a taxable period by a taxable person in the course of a taxable activity. The first question is to identify whether or not a taxable supply of goods was made by RMCC and PSL to the Appellant, and if so, whether such supply of goods had taken place at the time of the occurrence of any event specified in section 4(1) of the VAT Act.

[155] Section 83 of the VAT Act defines the term "goods" broadly as follows:

"goods" means all kinds of movable or immovable property, but does not include-

(a) Money;

(b) Computer software made to customers, special requirements either as unique programme or adaptation for standard programme, intercompany information data, and accounts, enhancement and update of existing specific programmes, enhancement and updating of existing normalized programmes supplied under contractual obligations to customers who have bought the original programme or where the value of contents separately identifiable in a software such sale of contents".

[156] In terms of section 83 of the VAT Act, "**supply of goods**" means-

*"The passing of exclusive ownership of goods to another as the **owner of such goods** and under the authority of any written law and includes the sale of goods by public auction, the transfer of goods under a hire purchase agreement, the sale of goods public auction, the transfer of goods under a fire purchase agreement, the sale of goods in satisfaction of a debt and the transfer of goods from a taxable activity to a non-taxable activity".*

[157] A supply of goods takes place when the exclusive ownership of the goods is passed to the buyer and where the seller had no exclusive ownership of the branded goods manufactured for and on behalf of the brand owner using its trademarks under its direction, supervision and control. In terms of the agreements, the Appellant as the registered user of the trademarks for manufacture, advertising, sale of branded goods got RMCC The and PSL to manufacture under its trademarks and RMCC and PSL have to manufacture

the goods under such trademarks and under its direction, specifications and control.

[158] It is settled law that the mere passing of property in an article or commodity during the course of performance of transaction in question does not render transaction to be transaction of the sale of these materials. This is clear from the judgment of the High Court of Gauhati in *Hindustan Aeronautics Ltd. v. State of Karnataka*, decided on 05.09.2001, paragraph 7:

> *"Mere passing of property in an article or commodity during the course of performance of the transaction in question does not render the transaction to be transaction of sale. Even in a contract purely of works or service, it is possible that articles may have to be used by the person executing the work, and property in such articles or materials may pass to the other party. That would not necessarily convert the contract into one of the sales of those materials. In every case, the Court would have to find out what was the primary object of the transaction and the intention of the parties while entering into it".*

[159] RMCC and PSL had no exclusive selling rights, either as the proprietor, or holder of trademarks, or registered user or licensee of the trademarks or otherwise. RMCC and PSL are only permissive users for the sole purpose of affixing the trademarks of the products made for and on behalf of the Appellant. RMCC and PSL had no authority, right or interest whatsoever, to manufacture or sell the finished products using the Appellant's trademarks without permission of the Appellant.

[160] The claimed supplies/sales made by RMCC and PSL are not sales to the exclusive marketing agent or wholesaler or other dealer or any other person as the exclusive owner of such products. They are not exclusive sales to the Appellant but merely supplies of manufactured branded goods to the registered trademark licensee for a fee.

[161] In this regard it is significant to refer to the judgment of the Supreme Court in *Whirlpool of India Ltd, Bangalore v. The Deputy Commissioner of Commercial Taxes, Bangapore* decided on 22.11.2006). The Appellant was the licensee and the registered user of the trademark "Whirlpool" and the Appellant entered into an agreement with M/s. Applicomp India Ltd. Under the agreement, Applicomp agreed to manufacture and supply electronic products and electrical appliances to the Appellant on the original equipment basis, as per the specifications of the Appellant.

[162] In terms of the agreement, Applicomp is neither a registered user nor a licensee in respect of the trade mark "whirlpool" and the agreement enabled Applicomp to manufacture products and affix the trade mark of the appellant to the products which are manufactured by Applicomp to the specifications of the Appellant. The agreement required Applicomp to exclusively supply to the products to the Appellant and not to affix the trademark any other product of Applicomp.

[163] The issue was whether the brand owner who is an exclusive purchaser of goods manufactured, using its brand name, by a manufacturer who is exempted under the Sales Tax Act of Karnataka is entitled to claim set off on the deemed tax paid on the purchases made from such manufacturer. The Supreme Court stated that in terms of the contract, Applicomp is neither a registered user nor a licensee of the trademark and thus, it is not selling the goods either as a trademark holder, or as one having any rights as the proprietor of the trademark or otherwise. The Supreme Court held at paragraph 10:

> *"In the present case, the appellant is the owner of the brand bane "Whirlpool" registered under the Trade and Merchandise Act, 1958. Under the agreement between the parties, the refrigerators and other consumer goods are got manufactured by M/s. Applicomp India Ltd, and as per the agreement M/s. Applicomp have to manufacture the products under the brand name "Whirlpool" and sell them exclusively to the appellant. M.s. Applicomp is not the registered user of the brand name "Whirlpool". Moreover, the sales made by M/s. Applicomp to the appellant, are not sales to the exclusive marketing agent or distributor or wholesale or any other dealer, but are only sales of manufactured branded goods to the brand owner.......".*

[164] In the present case too, the Appellant is the sole and exclusive licensee of the trademarks, and the branded products are manufactured by RMCC and PSL under its trademarks for and on behalf of the brand owner (the Appellant) under its control, direction, supervision. The sales made by RMCC and PSL to the Appellant without passing on the exclusive ownership of the goods as the owner of such goods, cannot be regarded as a supply of goods within the meaning of section 83 of the VAT Act. It is not the first sale to the Appellant whereas the sale made by the Appellant or by any other person on his account is the first sale. The use of the words "sale" or "sell" in the agreements will not make any difference as it is not the form of the contract but the substance that matters.

[165] The exclusive ownership of the branded goods could not have passed from RMCC and PSL for the mere issuance of invoices to the Appellant when the claimed sales made by RMCC and PSL could not constitute a "supply of goods", within the meaning of section 83 of the VAT Act. In my view, RMCC and PSL cannot be treated as sellers or suppliers of the products in question in terms of the agreements.

[166] In the circumstances, the supply of goods cannot be deemed to have taken place at the time of the issuance of invoices when there cannot be a supply of goods by RMCC and PSL within the meaning of section 83 of the VAT Act. In my opinion, the facts and circumstances brought on record clearly demonstrate that this transaction is not a buying and selling of goods for a profit-sharing basis. No such buying and selling transaction can be found within the substance of the agreements in question. In my view the Appellant's stand that it was engaged in the buying and selling business fails.

Exploitation of intangible property

[167] There is one other matter which I would comment upon is about the relevancy of IP rights to the present case. The Respondent has submitted that in terms of the Trade Mark License Agreement between the Appellant and Unilever PLC, UK, the Appellant's activity is captured in paragraph (e) of the definition of taxable activity. The Respondent's argument is that the Appellant, being a registered owner of the trademarks in Sri Lanka was exploiting the same and paying royalties to Unilever PLC, UK. The Respondent argued that therefore, the Appellant is engaged in a taxable activity within the meaning of the VAT Act by virtue of exploiting its intangible property.

[168] The Respondent submitted that the Appellant is engaged in supply of manufactured goods under its trademarks in the course of carrying or carrying out of a taxable activity within the meaning of section 2 of the VAT Act. In terms of the Trade Mark License Agreement, as the licensee of the trademarks of "Unilever", the Appellant is entitled to exploit the registered trademarks, to manufacture, packaging, advertising and sale of the products on an industrial scale under the licensed trademarks.

[169] The Appellant contends that a person who is making taxable supplies by the exploitation of intangible property cannot be engaged in the "supply of goods" because goods by their very nature are tangible. The submission

was that intangible character should not be regarded as 'goods' for the purpose of levying VAT. The term "goods" in section 83 of the VAT Act means-

"all kinds of movable or immovable property, but does not include-

(a) money;

(b) computer software made to customers special requirements either as unique programme or adaptation for standard programme, intercompany information data and accounts, enhancement and update of existing specific programmes, enhancement and update of existing normalized programmes supplied under contractual obligation to customers who have bought the original programme or where the value of contents separately identifiable in a software such value of contents".

[170] Dr. Kanag-Iswaran submitted that the term "goods" in Section 83 only includes tangible movable property and that the exploitation of the trademark is not tangible movable property. The definition of the term "goods" in section 83 of the VAT Act means all kinds of moveable property except those specified, namely, money and computer software and related programmes.

[171] The term "goods" meant all kinds of "movable property" and includes "all materials, articles and commodities", which are all movable property. The nature of intangible property is trademarks owned by Unilever PLC, UK, and the Appellant as its licensee is using Unilever trademarks on a non-transferable basis to manufacture, package, advertise and sell products using trademarks.

[172] In the present case, the intellectual property is not being used in its status, but in connection with products which are transformed to a marketable branded products using the trademarks for marketing and sale, closely linked with the manufactured finished products, which are movable at the time of the identification for sale. In *Advent Systems Ltd. v. Unisys Corporation* 1925 F, 2, 670, it was held that while a computer software program in its status is intangible and remains intangible, when it is transferred to a physical medium, it is a "good":

*"Computer programs are the product of an intellectual process, but once implanted in a medium they are widely distributed to computer owners. An analogy can be drawn to a compact-disc recording of an orchestral rendition. The music is produced by the artistry of musicians and in itself is not a 'good', **but when transferred to a laser-readable disc it becomes a readily merchantable commodity**. Similarly, when a professor **delivers***

a lecture, it is not a good, but, when transcribed as a book, it becomes a good**....."**

[173] There is no dispute that the taxable activity includes both tangible and intangible property within the meaning of the expression "taxable activity" in section 83 of the VAT Act. The question is whether it relates to a supply of goods or supply of service. The exploitation of any intangible property where such property is registered in Sri Lanka constitutes a separate taxable activity, and earning from such activity constitutes a supply of service.

[174] It is not in dispute that intellectual properties are intangible properties. They are not goods, and therefore, they fall outside the purview of 'goods' in section 83 of the VAT Act But, once such intangibles are captured and transferred to a physical medium, such as books, video cassette, manufactured products, they are capable of being abstracted, consumed, transferred, delivered, stored, possessed. Under such circumstance, they may become "goods" in movable form (*Tata Consultancy Services v. State of Andhra Pradesh* (05.11.2004 - SC), paragraph 28).

[175] In the present case, the Appellant is manufacturing its own goods affixing its own trademarks on its own finished products, and such manufactured products are capable of being physically moved from one location to another, delivered, stored, possessed and sold to another. They become "goods" in physical form within the definition of "goods" in section 83 of the VAT Act.

[176] The issue in the present case is whether the Appellant is a manufacturer of **goods** within the meaning of section 3(1)(a) of the VAT Act and therefore, it became necessary to consider whether the Appellant is engaged in the supply of goods made in the course of a taxable activity. It relates to the **supply of goods** and not a **supply of service**. If the taxable activity relates to the exploitation of intangible property (i.e. licensing or assignment), it is a supply of service rather than a **supply of goods**. Because intangible property in its status of intangible form cannot be "goods".

[177] The taxable activity carried out by the Appellant relates to the business of manufacturing goods and the Court has decided that the Appellant is engaged in the supply of goods in the course of the taxable activity referred to in paragraph (a) of the definition of "taxable activity" in section 83 of the VAT Act. In my view, the relevant taxable activity is captured in paragraph (a) of the definition of "taxable activity" in section 83 of the VAT Act. It is not

captured in paragraph (e) of the definition of "taxable activity" in section 83 of the VAT Act.

Supply of services

[178] In terms of section 83, "supply of services" means any supply which is not a supply of goods, but includes any loss incurred in a taxable activity for which an indemnity is due. Thus, the concept of supply of service is anything which is not a supply of goods. As noted, it is the Appellant who is engaged in a supply of goods by getting RMCC and PSL to manufacture branded goods to the Appellant under its direction, supervision and effective control.

[179] Although the manufacturing of goods was the final result of a single manufacturing agreement, the predominant part of the activity under the agreement was the **supply of goods** carried out by the Appellant in the course of a taxable activity under its direction, supervision and control. Where one or more elements in a single contract are to be regarded as constituting the principal activity whilst one or more elements are to be regarded as ancillary services, such services must be regarded as ancillary to a principal activity. If the element of supply of goods dominates the other elements, the dominant element is the **supply of goods** while the ancillary element is the **supply of service.**

[180] The work done by RMCC and PSL in making products by assembling raw materials and delivering goods to the Appellant could not have materially altered or transformed into different a finished product for sale having distinctive character, name, quality and use without the "effective control" and deep involvement of the Appellant. The Appellant is effectively and directly involved in the entire manufacturing process, and the work is done by RMCC and PSL under the Appellant's direction, supervision, control. RMCC and PS are not selling the goods as the exclusive owner, and not transferring the exclusive ownership to the Appellant. Their sales cannot constitute first sale as the exclusive owner of goods and thus, the question of passing ownership from RMCC and PSL to the Appellant will not arise.

[181] In the present case, the work of RMCC and PSL to whom the price was paid by the Appellant is not for the supply of goods, which does not involve a transfer of exclusive ownership of goods to the Appellant, but a price to make and supply of branded goods to the registered brand manufacturer under the manufacturer's effect control and deep involvement. It is not a

supply of goods or a sale of goods. A transfer of possession of the goods without transfer of exclusive ownership is only a supply of service in the execution of the agreement between the Appellant and RMCC/PSL.

[182] In the circumstances, the work done by RMCC and PSL as manufacturing service providers under the two agreements can only be considered as a supply of service to the Appellant who is the manufacturer. The Appellant is engaged in the supply of goods as the real manufacturer within the meaning of section 3(1)(a) of the VAT Act.

[183] For those reasons, I am of the view that the Appellant must be regarded as the manufacturer of the products in question within the meaning of section 3(1)(a) of the VAT Act, and the supply of manufactured goods shall be treated as a taxable activity within the meaning of the VAT Act.

[184] I hold that the TAC was correct in confirming the determination made by the Respondent, that the Appellant is engaged in the taxable supply of goods made in the course of the carrying on a taxable activity within the meaning of section 2 of the VAT Act.

Conclusion & Opinion of Court

[185] In the circumstances, I answer the questions of law arising in the case stated in favour of the Respondent and against the Appellant as follows:

1. No
2. No
3. The Tax Appeals Commission has come to the correct conclusion that the Appellant was the manufacturer for the purpose of the assessment.

   (a) No

   (b) No

[186] For those reasons, I confirm the determination made by the Tax Appeals Commission dated 07.03.2013, and the Registrar is directed to send a certified copy of this judgment to the Tax Appeals Commission.

JUDGE OF THE COURT OF APPEAL

<u>M. Sampath K.B. Wijeratne, J.</u>

I agree.

JUDGE OF THE COURT OF APPEAL