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

In the matter of an appeal by way of Stated Case on a question of law for the opinion of the Court of Appeal under and in terms of Section 11A of the Tax Appeals Commission Act, No. 23 of 2011 (as amended).

Dialog Broadband Networks (Private) Limited,
No. 475, Union Place,
Colombo 02.

APPELLANT

CA No. CA/TAX/0017/2019
Tax Appeals Commission
No. TAC/VAT/012/2015

v.

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

RESPONDENT

BEFORE : Dr. Ruwan Fernando J. &
M. Sampath K. B. Wijeratne J.

COUNSEL : Dr. Shivaji Felix with Nivantha Satharasinghe for the Appellant.

Chaya Sri Nammuni, DSG for the Respondent.

WRITTEN SUBMISSIONS	:	11.01.2021 & 29.12.2022 (by the Appellant) 30.03.2021 & 05.01.2023 (by the Respondent)
ARGUED ON	:	01.06.2022 & 14.10.2022
DECIDED ON	:	12.01.2023

M. Sampath K. B. Wijeratne J.

Introduction

Suntel (Private) Limited, was a limited liability company and the principal activities of the company are provision of wireless local loop telecommunication service for voice and data transmission. The Appellant, Dialog Broadband Networks (Private) Limited, being the holding company was amalgamated with Suntel (Private) Limited with effect from 15th May 2012, under and in terms of Section 242 (1) of the Companies Act No. 7 of 2007. Consequently, the Appellant, the continuing entity, made this appeal. When the Suntel (Private) Limited submitted its Value Added Tax (hereinafter referred to as the 'VAT') return for the month of May 2010, the Assessor rejected the same by his letter dated 12th December 2012[1] and made an assessment on the ground that the Suntel (Private) Limited had not declared the amount received from the Telecommunicated Regulatory Commission (hereinafter referred to as the 'TRC') of Sri Lanka, during the relevant taxable period. By the same letter, the Assessor communicated the reasons for not accepting the return. Thereafter, the Assessor proceeded to issue a Notice of Assessment[2].

The aggrieved Appellant appealed to the Commissioner General of Inland Revenue (hereinafter referred to as the 'CGIR'). The CGIR heard the appeal and made his determination on the 30th April 2015 confirming the assessment[3].

[1] At p. 85 of the appeal brief and paragraph 3 of the Written Submission filed by the Appellant on the 11th January 2020.
[2] At p. 6 of the appeal brief.
[3] At p. 1/23 of the appeal brief.

Being aggrieved by the aforesaid determination of the CGIR, the Appellant appealed to the Tax Appeals Commission (hereinafter referred to as the 'TAC').

The TAC having heard the appeal made its determination confirming the decision of the CGIR and dismissed the appeal on the 16th May 2019. The Appellant, aggrieved by the determination of the TAC, moved the TAC to state a case to this Court on the following four questions of law.

1. ***Has the Tax Appeals Commission erred in law when it is concluded that disbursements made by the Telecommunication Regulatory Commission of Sri Lanka out of the Telecommunication Development Charge Fund and received by the Appellant as a claim under Regulation 9 of the Regulations made by the Minister of Finance under and in terms of Section 26 of the Finance Act No. 11 0f 2004, constituted a taxable supply of service within the contemplation of the Value Added Tax Act, No. 14 of 2022 (as amended)?***

2. ***Did the Tax Appeals Commission erred in law when it failed to appreciate the fact that Appellant merely is a collecting agent for the state and, if it is correct, Value Added Tax must be recovered from the person who is the recipient of the service?***

3. ***Did the Tax Appeals Commission fail to appreciate the distinction between the refund of a tax (based on fulfilling criteria specified by regulations) and the provisions of a taxable supply of service?***

4. ***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?***

Factual Background

The Finance Act No. 11 of 2004 (as amended) provides that every International Telecommunication Operator should pay a prescribed percentage of levy to the TRC in relation to each incoming and outgoing

international call facilitated by an operator[4]. Regulations setting out the rate of the levy are made under Section 22 of the Finance Act. Section 23 and 26 provides for the issuance of guidelines for the implementation and giving effect to the provisions of the Act.

The tax on international inbound calls is levied on the basis of two separate fees, namely, *Incoming Local Access Charge (ILAC)* and *Telecommunications Developing Charge (TDC)* and credited to the respective fund. The operator may claim two-third of the funds in the *TDC* fund lying in the name of such operator, for the development of their telecommunication network in unserved and underserved areas of Sri Lanka as may be determined by TRC, within a period of three years.[5] Accordingly, Suntel (Private) Limited was granted a sum of Rs. 67,220,330/- on the 11th of May 2010 for their investment in specified areas.

As I have already stated above the Assessor issued the assessment in question in respect of this amount.

Analysis

The Assessor was of the view that the said sum of Rs. 67, 220, 330/- received by the Appellant from the TRC is a government grant for the investments made in the North and East which in terms of Section 2 of the VAT Act is received in the course of carrying on or carrying out a taxable activity. The Assessor was of the view that any supply which is not a supply of goods is a supply of services within the meaning of the VAT Act[6]. In my view, this can by no means be sustained.

In contrast to the foregoing, the CGIR confirmed the assessment relying on one of the objectives outlined on the TRC website, *'to promote rapid and sustained development of domestic and international telecommunication facilities.'* It was stated that construction of towers is one way of promoting development of domestic and international telecommunication facilities[7]. Accordingly, the receipt from the TRC was treated as consideration for a supply made to the TRC by the Appellant.

[4] Sections 21 & 22 of the Finance Act No. 11 of 2004 and International Telecommunication Operators Levy (Imposition) Regulations No. 01 of 2005 published in the Extra Ordinary Gazette Notification No. 1386/24 dated 31st March 2005.
[5] Regulation No. 5 & 9.
[6] At p. 85 of the appeal brief.
[7] At p. 9 of the appeal brief.

The issue to be determined in this appeal is whether the disbursements made by the TRC out of the *TDC* fund constitute a consideration for a taxable supply of services within the contemplation of Section 2 (1) (a) of the VAT Act No. 14 of 2002, as amended (hereinafter referred to as the 'VAT Act').

Section 2 (1) (a) of the VAT Act reads as follows;

> *2. (1) Subject to the provisions of this Act, a tax, to be known as the Value Added Tax (hereinafter referred to as "the tax") shall be charged –*
>
> > *(a) at the time of supply, on every* ***taxable supply*** *of goods or* ***services****, made in a taxable period, by a registered person* ***in the course of the carrying on, or carrying out****, of a* ***taxable activity*** *by such person in Sri Lanka;*
> >
> > *(b) (...),*
>
> *and* ***on the value of such*** *goods or* ***services supplied*** *or the goods imported, (...)'*

The terms *supply of services* and *taxable supply* are defined in Section 83, the interpretation Section, of the VAT Act as follows;

> *'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;*
>
> *'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.'*

The term *taxable activity* is defined as follows;

> *'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) (...)

(c) (...)

(d) (...)

(e) (...)'

As per Section 5 of the VAT Act, the value of a taxable supply of goods or services for VAT purposes is considered as follows.

'5. (1) The value of a taxable supply of goods or services, shall be such amount where the supply is-

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

(b) (...)

(2) – (14) (...)'

Thus, the value on which VAT is charged should not be lower than the *open market value.*

Section 83 of the VAT Act, the interpretation Section, defines *open market value* in the following manner.

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

Accordingly, in determining the *open market value*, the supply should be compared with a *similar* supply made in *similar* circumstances and not with an *identical* supply made in *identical* circumstances. Thus, the Assessor, in making the assessment, should have taken into account the ordinary construction cost of towers and base stations and not the amount disbursed by the TRC. Therefore, the assessment is equally flawed in law in the above aspect as well.

The Respondent submitted that since the asset of the towers remains in the hands of the Appellant, a lesser amount, two-third of money lying to the credit of the Appellant, was agreed as the consideration for the construction of towers and base stations[8]. I see no merit in the foregoing and it is also inconsistent with the principles of VAT recovery. The Respondent also argued that passing of the ownership of the towers is not a requirement in a context where there is a supply of services[9]. The Respondent's position in this matter is that the Appellant's predecessor supplied the tower and base station construction service to the TRC. In such a case, it is obvious that the ownership should pass to the TRC at the end of construction.

The Respondent relied on the judgement of the European Court of Justice in the case of *Vodafone Potugal- Communicacoes Pessoais SA v. Authoridade Tributaria e Aduaneira*[10] and argued that the payment of a predetermine amount such as in the instant case constitute a consideration for a supply of services under the VAT Act. It was further submitted that the term 'supply of services' has been construed widely in other jurisdictions. The facts of the aforementioned case are that Vodafone offered its customers special promotions, provided that customers continue to obtain Vodafone's services for a predetermined period. Failure of the customers to comply with the above condition obliged them to pay Vodafone the predetermined amount. The Court held that the payment of a predetermined amount constitutes the consideration for the services provided by Vodafone to its customers.

However, it is clear that the facts in the above case are significantly different from the case at hand. Vodafone, which was a telecommunications service provider, was contracted to provide its services to customers whereas in this case, none of these services were provided to the TRC. I am therefore of the view that the judgement of the abovementioned case has no application to the facts of the instant case.

In light of the above analysis, it is clear that the amount reimbursed by the TRC does not represent the value of a taxable supply of services under the VAT Act.

A further aspect which must be examined by the Court is that the basic principle of VAT is that the tax is levied on the final consumer.

[8] At paragraph 43 of the Respondent's Written Submission dated 30th March 2021.
[9] At paragraph 33 of the Respondent's Written Submission dated 05th January 2023.
[10] Case C/43/19, dated 11th June 2020.

Accordingly, VAT is collected by the registered persons in the VAT chain and remitted to the Inland Revenue Department. The registered persons will issue tax invoices for the supplies made by them and later, claim input tax from the Inland Revenue Department. Eventually, all VAT will be borne by the final consumer. Accordingly, if the amount received by the Appellant is vatable, then VAT has to be borne by the TRC.

Another argument advanced by the Appellant is that the refund of a fiscal levy based on certain eligibility criteria does not constitute a supply of services within the contemplation of the VAT Act. The Appellant submitted that TRC refunds only two third of the *TDC* paid by the Appellant when it meets an eligibility criterion. Accordingly, it was argued that the payment is not received for a service provided but, is a subsidy given by the TRC[11]. It is well known that the government provides subsidies for growing tea, rubber and coconut, and so on, to persons including those registered for VAT. The purpose of these subsidies is to encourage people to cultivate these crops, which in turn will increase production and not for any service supplied to the government under the VAT Act. It was also submitted that the payment was a mere refund of a tax already paid by the Appellant[12]. In fact, the disbursement is made out of the monies lying in the *TDC* fund in the name of the Appellant. The *TDC* fund consists of the International Telecommunication Operators Levy charged and levied from International Telecommunication Operators. The Appellant's predecessor being an International Telecommunication Operator as well as a Domestic Public Switched Telephone Network (PSTN) Operator[13], is entitled to claim two-thirds of the *TDC* funds for the developments made to their Telecommunications Network in unserved and underserved areas. A claim has to be made within three years from the relevant year. It is important to note that the TRC does not fully reimburse construction costs of the towers and base stations. Neither is it two-thirds of the total cost. It is only two-thirds of the cost elements set out in the guidelines published by the TRC are disbursed[14]. Further, the reimbursement is made on a claim made by the Domestic PSTN Operator for the development of their telecommunication network in unserved and

[11] At paragraphs 24 and 25 of the Appellant's Written Submission dated 29th December 2022.
[12] Ibid.
[13] Interpretation of the term Domestic PSTN Operator in Clause 24 of the Guidelines on the Disbursement of TDC, at p. 26 of the appeal brief.
[14] Note 01 of the Guidelines on the Disbursement of TDC, at p. 26 of the appeal brief.

underserved areas[15]. According to the TRC's own disbursement guidelines, construction of towers and base stations in specified areas is an investment made by a Domestic PSTN Operator[16]. My point of view too is that it is an investment made by the Appellant to enhance the services supplied to their subscribers. The principal ground on which the TAC concluded that the appellant is providing a service to the TRC is that the towers and base stations are built in specified areas in accordance with the guidelines issued by the TRC[17]. The TAC further observed that the amount paid by the TRC to the Appellant is not a voluntary payment made to each and every Domestic PSTN Operator and the payment would be received only upon fulfilment of the requirements of the TRC. Thus, the TAC determined that there is a contractual obligation to be fulfilled by the Appellant to receive the disbursement[18]. It is common knowledge that even a dwelling house is built according to the specifications of the local authority. Simply because one cannot say that there is a contractual obligation towards the local authority.

The TRC declares certain areas as unserved and underserved areas where development of telecommunication network is needed. When a Domestic PSTN Operator builds towers and base stations in these areas, the Domestic PSTN Operator is entitled to claim two-thirds of the *TDC* lying in their name, in the *TDC* fund. It is true that the TRC determines the unserved and underserved areas and specify the parameters of towers and base stations. Yet, those are not built on the request of the TRC. The Domestic PSTN Operators builds those on their own accord, in order to enhance the service provided to their customers. Therefore, this can never be a criterion to determine that the Appellant supplies a service to the TRC.

Moreover, towers and base stations are built in specified areas as well as in other areas. But a disbursement from the *TDC* fund will be made only in respect of towers and base stations built in specified areas.

The Respondent, referring to the Note to the Financial Statements of the Appellant in the working file, which is not available in the brief, submitted that the money received is referred to in it as a government grant. The Respondent argued that in a grant there is no possibility for the grantor to

[15] Regulation No. 9 made under Section 26 read with Section 22 of the Finance Act, No. 11 of 2004, published in Government Gazette Notification No. 1386/24 dated 31st March 2005.
[16] Clause 11 of the Guidelines on the Disbursement of TDC, at p. 27 of the appeal brief.
[17] At p. 132 of the appeal brief (P. 8 of the TAC determination).
[18] At p. 136 of the appeal brief (p. 4 of the TAC determination).

monitor and withdraw the grant on the failure to utilize the same as per specifications whereas the disbursement made by the TRC can be withdrawn[19]. However, it is well known that even a land grant can be withdrawn if the land is not utilized according to the specified terms and conditions.

The Appellant submitted that the Appellant is engaged in providing telecommunication services and is not providing any services as a construction contractor. It was also submitted that the payments to the contractor who constructed the towers and base stations were made by the Appellant and those are not been constructed for sale. Although, a payment pertaining to the construction of towers and base stations are made by the TRC, the ownership of those does not pass to the TRC[20].

Therefore, in my view, it is an incentive to the Domestic PSTN Operators to expand their coverage to unserved and underserved areas and not a consideration paid for a service provided by the Appellant.

As submitted by the Respondent, the tax refund in general is the refund of taxes overpaid. The Respondent also referred to Section 58 (1) of the VAT Act under which tax or penalty paid in excess is refunded. However, the amount concerned is clearly not a refund of VAT under Chapter X of the VAT Act. Nevertheless, the sums in the *TDC* fund are part of the levy charged and collected from International Telecommunication Operators. However, a Domestic PSTN Operator has the right to claim two-thirds of the *TDC* in a given year, within a period of three years from that year, after satisfying the criterion. In my view, a tax refund may occur in situations other than an overpayment of tax, such as the resolution of an appeal, etc. Therefore, it is my considered view that the disbursement made by the TRC has all the characteristics of a tax refund.

In view of the foregoing analysis, I hold that the disbursement is a refund of a fiscal levy upon fulfilling an eligibility criterion and not a payment made by the TRC in respect of a service supplied by the Appellant.

Conclusion

Thus, having considered all the arguments presented to this Court, it is my considered view that the TAC erred in law when it concluded that the

[19] At paragraphs 12 & 14 of the Respondent's Written Submission dated 30th March 2021.
[20] At paragraph 31 of the Appellant's Written Submission dated 28th December 2022.

disbursement made by the TRC to the Appellant out of the *TDC* fund constitute the consideration for a taxable supply of services.

Accordingly, I answer the four questions of law in favour of the Appellant in the affirmative.

1. ***Yes.***
2. ***Yes.***
3. ***Yes.***
4. ***Yes.***

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

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

JUDGE OF THE COURT OF APPEAL

Dr. Ruwan Fernando J.

I Agree.

JUDGE OF THE COURT OF APPEAL