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

In the matter of an Application of a case stated under Section 11A of the Tax Appeals Commission Act No. 23 of 2011 as amended by Act No. 20 of 2013.

The Commissioner General of Inland Revenue,

Department of Inland Revenue,

Inland Revenue Building,

Sir Chittampalam A. Gardiner Mawatha,

Colombo 02.

Appellant

Court of Appeal Application No: **CA/TAX/0001/2021**

Case Stated: **TAC/IT/016/2017**

Vs.

Aitken Spence Travels Limited,

305, Vauxhall Street,

Colombo 02.

Respondent

BEFORE	:	D. N. Samarakoon J Neil Iddawala J
COUNSEL	:	Chaya Sri Nammuni DSG with A. Weerakoon SC for the Appellant. Dr. K. Kanag Iswaran P.C. with Shivaan Kanag Iswaran for the Respondent.
Argued on	:	26.06.2023
Written Submissions filed on	:	27.07.2023
Decided on	:	27.09.2023

<u>Iddawala – J</u>

This is an application made by the Commissioner General of Inland Revenue (*hereinafter referred to as the Appellant)* under the Tax Appeals Commission Act No. 23 of 2011 as amended challenging a decision made by the Tax Appeals Commission (*hereinafter referred to as the TAC)* allowing a tax exemption to Aitken Spence Travels Limited (*hereinafter referred to as the Respondent).*

The instant appeal is made against the assessment made for the taxable period 2011/2012 which was heard by the TAC on 01.10.2019. The respondent provides travel related services to clients such as Foreign Tour Operators (FTO) who organise tours to tourists visiting Sri Lanka. In the present matter, the respondent has claimed a tax exemption under Section 13(ddd) of the Inland Revenue Act No. 10 of 2006 as amended (*hereinafter referred to as the IR Act).* The Assistant Commissioner of the Inland Revenue Department had rejected the returns submitted by the

respondent for the said assessment year and had issued assessment for the period without granting the claimed exemption.

Upon disagreeing with the decision, the respondent has appealed to the appellant, where on 15.12.2016 the appellant affirmed the decision of the Assistant Commissioner. The respondent being dissatisfied with the said determination has appealed to the TAC on 27.02.2017 complying with Section 7 of the Tax Appeals Commission Act No. 23 of 2011 as amended (*hereinafter referred to as the TAC Act).*

The TAC, after considering the submissions made by the two parties at the hearing appeal, has held on 25.08.2020 that the respondent is entitled to the respective tax exemption under Section 13(ddd) of the IR Act. Thereafter the appellant has requested the TAC on 23.09.2020 requesting to have a case stated for the opinion of this Court. The main contention at the hand of the TAC was whether the respondent falls within the ambit of Section 13(ddd) of the Act. Having regard the material available, TAC was of the view that the respondent cannot be denied the tax concessions claimed vis-à-vis the services performed by the respondent company on behalf of the FTOs. The questions of law raised by the appellant in the instant case in accordance with Section 11A of the TAC Act are as follows;

1. *Has the TAC erred in interpreting Section 13(ddd) of the IR Act as the FTOs were the recipient of the services rendered by the respondent company, not the foreign tourists who were physically present in Sri Lanka?*

   Section 13 (ddd) of the IR Act: (There shall be exempt from income tax)—the profits and income earned in foreign currency by any resident company, any resident individual or any partnership in Sri Lanka, from any service rendered in or outside Sri Lanka to any person or partnership outside Sri Lanka, other than any commission, discount or similar receipt for any such service rendered in Sri Lanka, if such profits and

income (less such amount, if any, expended outside Sri Lanka as is considered by the Commissioner-General to be reasonable expenses) are remitted to Sri Lanka through a bank.

2. *Whether the TAC erred in determining that the respondent company can treat as dependent agent satisfying the requirements for a Permanent Establishment (PE) of each FTO under the Double Tax Agreements between Sri Lanka and the country of the particular FTO?*

In answering the first question of law in the case stated, this Court would like to deconstruct Section 13(ddd) of the IR Act incorporated by the amendment of Act No. 09 of 2008, depicting the requisites of the provision to be exempted from income tax.

1. the profits and income earned in foreign currency
2. by any resident company, any resident individual or any partnership in Sri Lanka,
3. from any service rendered in or outside Sri Lanka
4. to any person or partnership outside Sri Lanka
5. other than any commission, discount or similar payment
6. if such profits and income (less such amount, if any, expended outside Sri Lanka as is considered by the Commissioner-General to be reasonable expenses) are remitted to Sri Lanka through a bank

The most contentious limb of the provision vis-à-vis the instant matter has being determining whether the service recipient of the respondent is situated inside or outside Sri Lanka. The TAC in their decision has assessed the relationship between FTOs and the tourists and the FTOs and the respondent. The TAC determination states that the FTOs based outside Sri Lanka have entered into contracts with the respondent and the respondent at the request of the FTOs arrange the contents of the tour package such as hotels, transportation and excursions, sold by the FTO to its tourists. The respondent provides services to the foreign tourists at the

request of the FTOs and the respondent is paid by the FTO. The TAC further reasons that although there is a binding agreement between foreign tourists and the FTO there is no such agreement between the respondent and the foreign tourists, thereby, for any shortcomings in services provided by the respondent it is only the FTO that can claim damages from the respondent and the tourists have no cause of action against the respondent. The view of the TAC on the argument of the appellant that the foreign tourists were physically present in Sri Lanka and there was provision of services to them, is that, as there is no binding agreement between the foreign tourists and the respondent and as there is one between the respondent and the FTOs which are located outside Sri Lanka, the particular activity of the respondent company becomes a provision of services to an entity outside Sri Lanka and thereby is eligible for the income tax exemption. In the instant application, the same argument has been made by the appellant in their submissions and this Court is inclined to accept the determination of the TAC on this contention to be valid and well-reasoned.

As the TAC has rightly analysed, the income received by the respondent in foreign currency is remitted by the FTOs. As Section 13(ddd) mentions, provision of services could be in or outside Sri Lanka, however the service recipients with a binding contractual obligation are located outside Sri Lanka. Thus, although technically the respondent provides a service to the foreign tourists within Sri Lanka by conducting the aforementioned activities, the income in foreign currency which is eligible for the tax exemption is remitted only by the FTOs. Therefore, the service provided to foreign tourists is irrelevant and immaterial for tax exemptions under the IR Act. In the case of ***Commissioner General of Inland Revenue vs Aitken Spence Travels (Pvt) Ltd.*** CA No. CA/TAX/0031/2019 dated 26.05.2022, a case between the same parties for the assessment year of 2010/2011; Sampath K. B. Wijeratne J. held the same view and reasoning. His Lordship also referred to the English case of ***Commissioners of Customs and Excise vs Plantiflor Limited*** [2002] UKHL 33 to determine

the nature of the contractual obligations between three parties who entered into two separate but related bilateral contracts. In this case it was held that a particular activity, conducted between the two parties who have not entered into a binding agreement with each other, is considered to be conducted pursuant to the relevant party's pre-existing contract with the other party which is entered into by both parties as principals. Wijeratne J. elaborates that "*ASTL provides two different types of services, firstly to FTO of the right to have the services agreed between the FTO and ASTL rendered to the foreign tourists in Sri Lanka and secondly, the provision of agreed services to the foreign tourists in Sri Lanka. ASTL earns an income by providing their services to FTO who are outside of Sri Lanka. On the other hand, even though ASTL provides agreed services to foreign tourists, ASTL does not earn an income from them".*

At this juncture, this Court believes it is necessary to mention the case of ***Commissioner General of Inland Revenue vs Aitken Spence Travels (Pvt) Ltd*** CA No. CA/TAX/04/2016 dated 13.11.2018, case between the same parties for the assessment year of 2009/2010. In this case the Court has identified two types of services in existence which was later followed by Wijeratne J. in the aforementioned case. However, this Court refrains from referring to the deduction of the aforementioned judgment as this Court has reservations and ambiguities about the reasonings of the said case.

The predominant factor to find the decision of TAC to be accurate is that, the income is remitted to the respondent only by the FTO and not by the foreign tourists, thereby, the service provided to the foreign tourists is irrelevant and immaterial within the ambit of Section 13(ddd) of the IR Act, Furthermore, in arriving at this determination, this Court would like to emphasise the purpose of tax exemptions in an economy. Tax exemptions on foreign remittance are generally granted to incentivise resident entities to increase foreign activities, thereby, increasing the flow of foreign currency to the local economy. This can enhance the livelihood and the

economy of a country. Further, this particular exemption encourages resident entities to use legal and legitimate means of remittance i.e. banks, without resorting to illegal and cheaper methods to remit foreign income. On one hand this supports the local banking system and on the other hand it helps with assessing and calculating the economic realities.

The second question posed to this Court in the case stated is whether the TAC erred in determining that the respondent company can be treated as dependent agent satisfying the requirements for a Permanent Establishment (PE) of each FTO under the Double Tax Agreements between Sri Lanka and the country of the particular FTO. When perusing the decision of the TAC it is evident that the TAC has not conclusively determined the respondent to be a dependent agent or an agent, although that argument submitted by the appellant is discussed in Page 09 of the TAC decision. Furthermore, information relevant to determine this matter, such as the locations of FTOs, existence of double tax agreements with such countries are not sufficiently presented to this Court. As an example, the case of ***Johnson and Johnson (Private) Limited vs Commissioner General of Inland Revenue*** CA No. CA/TAX/0039/2019 dated 27.05.2022, had the same question of law in their case stated. In the judgement Dr. Ruwan Fernando J. extensively analysed the double taxation agreements and the TAC had overtly determined on this matter in their assessment. Further, there was requisite facts and information presented to the Court to opine. This Court also noted that this particular question of law has not been contended in previous cases between the same parties for prior assessment years.

For the reasons set out above, this Court holds that the TAC did not err in law when it arrived at the conclusion that it did. Accordingly, this Court answers the questions of law in the case stated for the opinion of this Court as follows:

1. **No**, the TAC correctly interpreted the service recipient under Section 13(ddd) of the IR Act.

2. **No,** the TAC has not determined the respondent to be a dependent agent of the FTOs.

In light of the answers given to the above two questions of law, acting under Section 11A (6) of the TAC Act, this Court confirms the determination of the TAC. The Registrar of this Court is directed to send a copy of this judgment to the Secretary of the TAC.

Application dismissed.

JUDGE OF THE COURT OF APPEAL

D. N. Samarakoon J.

I agree.

JUDGE OF THE COURT OF APPEAL