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

In the matter of a Case Stated for the opinion of the Court of Appeal under section 11A of the Tax Appeals Commission Act, No 23 of 2011 (as amended).

CA/TAX/0019/2015
Tax Appeals Commission
TAC/OLD/IT/044

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

APPELLANT

Vs.

1. Osprey Clothing (Private) Limited,
   929/929B, Main Road,
   Nawagamuwa,
   Ranala.

RESPONDENTS

Before: Sobhitha Rajakaruna J.
Dhammika Ganepola J.
Counsel: Chaya Sri Nammuni DSG for the Appellant
Dr.Shivaji Felix with Nivantha Satharasinghe for the Respondent
Argued on: 02.10.2023
Written Submissions- Appellant - 28.08.2019
Respondent - 18.06.2018,13.05.2020, 27.11.2023
Decided on: 24.01.2024

Sobhitha Rajakaruna J.

In terms of section 11A (2) of the Tax Appeals Commission Act No 23 of 2011, the Appellant tendered to this Court by way of a motion dated 14.12.2015 the 'Case Stated' and annexures thereto marked 'X1' to 'X4'.

The Respondent - Osprey Clothing (Private) Limited ('Company') entered into an agreement ('1st Agreement') with the Board of Investment of Sri Lanka ('BOI') on 10.06.1992 to set up

and operate a business of manufacturing and exporting apparel at *Kantale*. The Period for which the tax exemption was granted to the Respondent under the said Agreement is 15 years from the year of assessment. Subsequently, on 25.05.1993 another Agreement ('Supplementary Agreement') was entered into between both the above parties. In view of the said Supplementary Agreement the Respondent sought approval from the BOI for the establishment of a washing plant, finishing section and bounded warehouse in *Nawagamuwa,* in addition to the business referred to in the 1st Agreement.

The core issue that needs to be resolved in the instant Application is whether the Respondent is entitled for tax relief under BOI law in respect of the said washing plant, finishing section and bounded warehouse established in *Nawagamuwa.* The Tax Appeals Commission ('TAC') based on the contents of Clause 10 of the 1st Agreement decided that the Tax exemption granted in favor of the Respondent applies even to the business activities relating to the washing plant etc.

The following questions were raised before the TAC by the Appellant for the opinion of this Court:

1. "Whether the Tax Appeals Commission disregarded the term 'said business' and entitlement of 'exemption' in the principal Agreement dated 10th June 1992
2. Whether the Tax Appeals Commission has erred in the determination, the recital of the principal Agreement was amended so as to take the newly introduced business under the reference of 'the said business'.
3. Whether the Tax Appeals Commission has erred in law to determine the scope of which the tax exemption granted under the principal Agreement of BOI and the Supplementary Agreement
4. Whether the Tax Appeal Commission has erred by disregarding the restriction clauses 5(d) and 5(e) in the principal Agreement." (Vide – 'Case Stated' dated 02.12.2015)

The stand taken by the Commissioner General of Inland Revenue before the TAC was that the tax exemption granted for 15 years under Clause 10 of the aforesaid 1st Agreement, does not cover the whole profit and income of the Company but it is limited to the profit and

income from manufacturing and exporting apparels which is the business described in the said 1st Agreement. The alleged basis for such an argument is that the business referred to in the Supplementary Agreement is different from the business declared in the 1st Agreement.

Clause 5 of the said Supplementary Agreement declares that the said Agreement is supplemental to the aforesaid 1st Agreement of which certain Clauses have been modified. On perusal of the said Supplementary Agreement, it implies that the respective parties have entered into the said Agreement based on the conditions and stipulations contained in the letter dated 04.03.1993 signed by the Director General of BOI (page 304 of the Brief). The approval to set up an enterprise establishing a washing plant, finishing section and bounded warehouse has been approved by the BOI through the said letter. The said letter of approval, among several other conditions stipulates that all income of the enterprise should be received in convertible foreign currency. The said Supplementary Agreement was authenticated by the parties following the said letter of the BOI and both parties arrived at a mutual agreement in respect of all its Clauses.

It is noted that the Supplementary Agreement consists of just 5 clauses, all of which are intended to amend the said 1st Agreement. By its 1st Clause, a new paragraph has been inserted immediately after the recital of the 1st Agreement and the granting of approval of the establishment of the said washing plant, etc., is displayed therein. The 2nd Clause of the said Supplementary Agreement is to replace Clause 1 of the 1st Agreement with the following Clause:

> *"Clause (1) of the said Agreement is hereby deleted and the following new clause (1) is hereby stipulated therefor-*
>
> *(1) The Enterprise shall be entitled to and shall set up/conduct and operate the said business at Kantalai in the Eastern Province and washing Plant, finishing section and bounded warehouse at Low Level Road, Nawagamuwa subject to the terms and conditions set out in the Board's letter of 04th March 1993 shall be in accordance with the undertakings, representations, commitments and proposals made by the Enterprise and set out in the said application and all correspondence connected therewith and included those enumerated in the Second Schedule of the said Agreement and in the Schedule hereto*

and subject to the terms and conditions hereinafter provided and subject to the provisions of the said Law No. 4 of 1978 and any amendments thereto and other rules and statutory regulations as may be applicable thereto."

The Commissioner General of Inland Revenue has raised in argument before the TAC that the literal meaning of Clause 10 of the 1st Agreement, by which the tax exemption has been granted, suggests that the following three requisites need to be fulfilled to fall under the category of the 'said business' which includes washing plant etc., in order to be entitled to tax exemption (Vide- page 226 of the Brief) -

" 01. The business should be of manufacturing and exporting apparels.

02. The products should be exported totally and exported in the name of enterprise

03. The business should be carried on in Kantalai Eastern Province."

Further, referring to Clause 5(d) and 5(e) of the 1st Agreement, the Commissioner General of Inland Revenue argues that no sub-contract work can be carried out without prior approval of the BOI. There is no doubt that by the said Supplementary Agreement only one Clause and the recital of the 1st Agreement have been amended.

After a careful examination of the Clauses of both the 1st Agreement and the Supplementary Agreement, I take the view that the said 1st Agreement has been amended only to a certain extent by the Supplementary Agreement and all the Clauses which were not amended remain fully enforceable and binding on the parties along with the above-mentioned amended Clauses thereto. Therefore, it cannot be assumed that the Supplementary Agreement has permitted the Company to carry out sales within Sri Lanka in respect of the washing plant etc., and it is merely because Clause 5 of the 1st Agreement has not been amended at all. According to Clause 5(e) of the 1st Agreement what is restricted is to engage in subcontract work by the Company and as such it is a misconception that the Company cannot expand its business as a result of the provisions of the said Clause 5(e).

A primary agreement can be assumed as the primary source of legal rights and the obligations of the relevant parties. The supplemental agreement usually derives its legal effect from the primary agreement. The modifying, extending or clarifying of the terms of the primary

agreement by a supplementary agreement is usually done with the express consent of the parties. The types of Supplementary Agreements can be considered amendments, addendums, side letters, waivers and riders. The principle of Novation cannot be invoked as a defense when expressed consent of all parties exists upon all the conditions of a supplementary agreement. As far as the terms agreed upon by the parties in the primary agreement and the supplementary agreement are lawful such agreements should be considered valid contracts. In the instant case the Appellant does not even raise any objection on the legality of both the 1st and the 2nd agreements but what he attempts to do is to give an interpretation on whether tax exemption is applied to the "business" which includes washing plants etc.

I cannot find any lawful reason to accept the arguments of the Commissioner General of Inland Revenue that the tax exemption granted to the Company does not apply to the profits and income of the business enhanced under the Supplementary Agreement. I take this view especially because I am not convinced that inserting a new recital has not made any effect on the provisions of the tax exemption clause (Clause 10) and also due to the reason that the BOI has expressly permitted the enhancement of business of the Company under the basic terms and conditions contained in the 1st Agreement. The Company contends that he said washing plant etc., is not an extension of their garment factory but a separate business. When considering the overall circumstances of this case I take the view that the provisions of the Supplementary Agreement have not exerted any influence on the said Clause 10 of the 1st Agreement.

At this juncture I need to take into account the letter dated 09.06.2006 addressed to the Commissioner General of Inland Revenue by the BOI (at page 279 of the Brief). According to the said communication the BOI has categorically confirmed that the establishment of a washing plant, finishing section and bounded warehouse at Low Level Road, *Nawagamuwa* by the Company, has been approved by the BOI on 04.03.1993 and it forms part and parcel of the business of the Company (Osprey Clothing (Private) Limited). The BOI has written the above letter referring to a letter dated 06.06.2006 (at page 280 of the Brief) by which the Company has disclosed that two additional activities (washing plant and finishing section) also comprises of the main business activities of the Company and do not conform to any sub-

contract work. In the meantime, it is important to draw my attention to the Application for approval of an investment dated 19.11.1992 (at page 311a of the Brief) in which the Company has expressed its intention to establish the washing plant etc. According to the said Application such intention has been described as follows:

> *"The annual quantities of washing from Maldives will be approximately 80,000 dozens. This quantities will have to be finished in our factory and exported from Sri Lanka. For this purpose we will have to set up a finishing unit in the same premise to undertake certain sewing operations (Button attaching, Bartacking), ironing operation and export packing. "*

This Court in ***Ace Healthcare (Pvt) Ltd v. Major General (Retired) Vijitha Ravipriya, Director General of Customs and Others CA / WRIT / 171 / 2022 decided on 30.05.2023*** referring to the BOI Agreement relevant to the said case observed that several Clauses of the agreement tend to provide that all taxes and levies in respect of importation of items other than the Customs duties are payable based on the applicability. Further the Court has decided in the said case that the CESS is a levy distinct to the Customs duties referred to in section 10 of the Customs Ordinance and further an appropriate branch of the Government must have the authority to inquire into related goods which are imported against the terms of a BOI Agreement. However, in light of the above reasons I hold that the Company is not liable to pay tax as per the assessment made for the taxable period 2003/2004.

In ***Ceylon Quartz Industries (Private) Limited vs. The Director General of Customs, S.C. Appeal No. 79/2002 decided on 04.10.2012.*** Dr. Shirani A. Bandaranayake CJ. has stated;

> *"As referred to earlier BOI was introduced and established chiefly for the purpose of attracting investments within the country. With the said objective in mind various concessions were offered for the investors. In this process the BOI was introduced as a 'One Stop Shop' mainly to indicate that there will not be any unnecessary hazzles in carrying out their business by the investors. This position is clearly demonstrated by Clause 10 of the Agreement, which lists out the benefits, exemptions and/or privileges that are granted to the Enterprises in connection with the relevant businesses. In that, Sub Clause (ix), referred to earlier, clearly stated that, all goods, articles, manufactured and/or produced by the Enterprises may be exported outside Sri Lanka free of export duty and more importantly, any custom or export control. The said Clause 10 (ix) also*

states that, the said goods produced by the Enterprises should be in accordance with the agreements entered into by the said Enterprise with the BOI."

The powers of the BOI in relation to entering into agreements with any enterprise is stipulated in section 17 of the Board of Investment of Sri Lanka Law. In terms of section 17(2) every such agreement shall be reduced to writing and shall upon registration with the BOI, constitute a valid and binding contract between the BOI and the Enterprise. However, the said Law does not expressly indicate any restriction of BOI including two distinct businesses of an Enterprise in the same agreement. In the instant Application it is noted that the BOI was inclined to include the Company's apparel business and the business in relation to the washing plant etc., in the 1st Agreement by introducing amendments through the said Supplementary Agreement.

In these circumstances, I answer the questions raised, before the TAC, for the opinion of this Court, in the negative form as follows:

Question 1 : No

Question 2 : No

Question 3 : No

Question 4 : No

For the reasons given above, I affirm the determination made by the TAC dated 22.10.2015. The Registrar is directed to send a certified copy of this judgment to the TAC.

Judge of the Court of Appeal

Dhammika Ganepola J.

I agree.

Judge of the Court of Appeal