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

In the matter of a Case Stated under Reference No. TAC/OLD/VAT/001 by the Tax Appeals Commission under Section 36 of the Value Added Tax Act No. 14 of 2002 (as amended)

CIC Agri Businesses (Private) Limited,
205, 1/1 D.R. Wijewardena Mawatha,
Colombo 10.

Appellant

Case No. CA (Tax) 42/2014
TAC Case No. TAC/OLD/VAT/001

Vs.

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

Respondent

Before: Janak De Silva J.

N. Bandula Karunarathna J.

Counsel:

F.N. Gunawardena for the Appellant

Manohara Jayasinghe SSC for the Respondent

Written Submissions tendered on:

Appellant on 02.07.2018

Respondent on 28.06.2018

Argued on: 08.05.2019

Decided on: 29.05.2020

Janak De Silva J.

The Appellant is a limited liability company engaged in importing and processing fertilizer and its sale to customers.

The Appellant has received a subsidy from the Government in respect of its fertilizer sales and the Appellant has treated such subsidy as an amount which is not liable to Value Added Tax (VAT) in terms of the Value Added Tax Act No. 14 of 2002 (as amended) (VAT Act).

The Assessor issued an intimation letter under section 29 of the VAT Act stating that the subsidy is liable to VAT on the basis that the subsidy is a consideration received by the Appellant for the difference between the market value of the product and the actual sales price fixed by Government policy.

Thereafter the Respondent issued an assessment on the Appellant for the month ending 31st August 2002 (Assessment No. 9822336) and month ending 30th November 2002 (Assessment No. 9822337) and month ending 31st January 2003 (Assessment No. 9823032).

The Appellant appealed against the said assessment in relation to the subsidy and conceded its liability to pay VAT due in relation to the sale proceeds of vehicles and insurance received which was also the subject matter of the assessments.

The Respondent made its determination confirming the assessment and held that the consideration received or receivable as subsidy in respect of the taxable period should be treated as a part of the taxable supply of the Appellant and the value of the subsidy should be treated as a taxable supply inclusive of VAT.

The Appellant appealed to the Board of Review, which appeal was determined by the Tax Appeals Commission (TAC) where it annulled the assessment which was made on the basis of the subsidy being liable to VAT but made a determination disallowing the input tax credit attributable to the relevant subsidy.

Aggrieved by the said determination the Appellant moved for a Case Stated to be submitted to this Court on the following questions of law:

1. Is the determination made by the TAC dated 30th September 2014 a nullity in view of the determination not being made within the time limit specified in Section 10 of the Tax Appeals Commission Act No. 23 of 2011 (as amended)?

2. Is the TAC entitled to make a determination with regard to the disallowance of a claim of the Appellant for input tax credit in view of

    a. The assessments numbered 9823032, 9822336, 9822337 and. 98222338 not being issued on any such basis; and/or

    b. The Appellant not being granted an opportunity to appeal against the assessment on the basis of the disallowing of input tax credit; and/or

    c. The Appellant nor the Assessor having adduced any such arguments in the hearings before the Commissioner General of Inland Revenue; and/or

    d. The determination which has been made by the Commissioner General of Inland Revenue dated 19th January 2006 not making a determination with regard to the disallowing of input credit; and/or

    e. The appeal which has been submitted by the Appellant against the determination made by the Commissioner General of Inland Revenue not being on the basis of any disallowing of input credit; and/or

    f. The arguments being adduced by the Commissioner General of Inland Revenue before the Tax Appeals Commission at the latter stage of the hearings being directly in conflict with the basis on which assessments have been issued and appeals hereinbefore were conducted before the Commissioner General of Inland Revenue and Tax Appeals Commission

3. Is the determination made by the Tax Appeals Commission disallowing the claim of the Appellant (which has already been allowed by the Commissioner General of Inland Revenue) for input tax credit erroneous in law?

Question 1: Time Bar

The learned counsel for the Appellant submitted that in terms of the TAC Act, the TAC should have determined the appeal within twenty-four months from the date on which the TAC commenced its sittings.

It was submitted that the appeal was first heard on 5th July 2012 whereas the determination was made only on 30th September 2014 and as such the determination of the TAC should be considered as a nullity. The decision of this Court in A.H. *Mohideen v. Commissioner General of Inland Revenue* [CA 02/2007, C.A.M. 16.01.2014, (2015) Vol. XXI BALJ 171] was cited in support.

The learned counsel for the Appellant relying on the fact that the first hearing took place on 5th July 2012, submitted that this is the date from which time runs in determining whether the determination of the TAC is time barred. He further submitted that upon a consideration of the several amendments made to the TAC Act, the time limit granted to the TAC to make a determination is mandatory which requires strict compliance. It was submitted that in the instant case the determination was made after the 270 days contemplated by section 10 of the TAC Act and hence it is time barred.

In addressing this question, the fundamental issue to be determined is whether the time limit given in section 10 of the TAC Act is directory or mandatory. The question whether a provision in a statute is mandatory or directory is not capable of generalization but when the legislature has not said which is which, one of the basic tests for deciding whether a statutory direction is mandatory or directory is to consider whether violation thereof is penal or not. It has been the traditional view that where disobedience of a provision is expressly made penal it has to be concluded that the provision is mandatory whereas if no penalty is prescribed non-compliance with the provisions of a statute may held to be directory.

The TAC Act does not specify any penal consequences for the failure of the TAC to make its determination within the time limit specified in section 10 of the TAC Act.

Furthermore, *Maxwell on Interpretation of Statutes*, 11th Edition, at page 369 states:

> *"Where the prescription of a statute related to performance of a public duty and where invalidation of acts done, in neglect of them would work serious general inconvenience or injustice to persons who have no control over those entrusted with the duty yet not promote the essential aims of the legislature, such prescriptions seem to be generally understood as mere instructions for the guidance and government of those on whom the duty is imposed, or, in other words, as directory only. Neglect of them may be penal, indeed, but it does not affect the validity of the acts done in disregard of them. It has often-been held, for instance,* ***when an Act ordered a thing to be done by a public body or public officers and pointed out the specific time when it was to be done, then the Act is directory only and might be complied with after the prescribed time.***" (emphasis added)

In *Nagalingam v. Lakshman de Mel* (78 NLR 231 at 237) in respect of a similar situation where the Commissioner of Labour had not made his order within the time prescribed under the Termination of Employment of Workmen (Special Provisions) Act No. 45 of 1971 Sharvananda J. (as he was then) held:

> "The delay should not render null and void the proceedings and affect the parties, as the parties have no control over the proceedings. It could not have been intended that the delay should cause a loss of jurisdiction, that the Commission had to give an effective order of approval or refusal. In my view, a failure to comply literally with the aforesaid provisions does not affect the efficacy or finality of the Commissioner's order made thereon. **Had it been the intention of the Parliament to avoid such order nothing would be simpler than to have so stipulated.** " (emphasis added)

Furthermore, in *Visuvalingam v. Liyanage* [(1985) 1 Sri.L.R. 203] a Bench of nine Judges of the Supreme Court considered whether Article 126 (5) of the Constitution is mandatory or directory. Article 126 (5) of the Constitution provides that when an application to the Supreme Court for relief against violation of fundamental rights guaranteed by the Constitution has been made "the Supreme Court shall hear and finally dispose of any petition or reference under this Article within two months of the filing of such petition. . .". The Supreme Court by a majority held that the provisions of Article 126 (5) of the Constitution are directory and not mandatory. Dealing with the argument that Article 126 (5) is mandatory and that even a fault of the Court is no excuse, Samarakoon, C.J. said (at page 226) that:

> "If that right was intended to be lost because the court fails in its duty the Constitution would have so provided. It has provided no sanction of any kind in case of such failure. To my mind it was only an injunction to be respected and obeyed but fell short of punishment if disobeyed. I am of opinion that the provisions of Article 126 (5) are directory and not mandatory. Any other construction would deprive a citizen of his fundamental right for no fault of his. While I can read into the Constitution a duty on the Supreme Court to act in a particular way, I cannot read into it any deprivation of a citizen's guaranteed right due to circumstances beyond his control".

Although the above case was one involving a violation of a fundamental right, the logic of the reasoning of Samarakoon, C.J. is compelling and applicable to the present case as well. In terms of section 8(1) of the TAC Act, it is only a person who is aggrieved by the determination of the Commissioner General of Inland Revenue in relation to the imposition of any tax, levy, charge, duty or penalty or the Director General of Customs under subsection (1B) of section 10 of the Customs Ordinance who can prefer an appeal to the TAC. Section 9(10) of the TAC Act allows the TAC on appeal to confirm, reduce, increase or annul, as the case may be, the assessment determined by the Commissioner General of Inland Revenue or to remit the case to the Director General of Customs.

The TAC Act does not spell out any sanction for the failure on the part of the TAC to comply with the time limit set out in section 10 of the TAC Act. If the Appellant is correct in submitting that the time bar on the TAC is mandatory, it will result in the validity of the impugned determination made by the Commissioner General of Inland Revenue being maintained for no fault of the aggrieved party where the TAC fails to adhere to the time limit. Such deprivation of rights of the aggrieved party cannot be implied in the absence of clear and unambiguous statutory provisions.

In this context, I wish to address the submission made by the learned counsel for the Appellant that the determination of the TAC should be considered a nullity as it was not made within the prescribed time period.

On the question of nullity, there are two judgments of this Court in *Ashokan v. Commissioner of National Housing* [(2003) 3 Sri.L.R. 179] and *Leelawathie and Another v. Commissioner of National Housing* [(2004) 3 Sri.L.R. 175] where Sripavan J. (as he was then) quotes with approval Lord Denning in *Mcfoy v. United Africa Co. Ltd.* [(1961) 3 All E.R. 1169 at 1172] where he said "You cannot put something on nothing and expect it to stay there, it will collapse".

However, in *Ashokan v. Commissioner of National Housing* (supra) the Petitioner specifically sought a quashing of A9 which was the decision that was held to be a nullity. In *Leelawathie and Another v. Commissioner of National Housing* (supra) Sripavan J. was not confronted with a situation of futility arising from the absence of any relief sought against a decision that was a nullity.

It is apposite to briefly set out at this point the meaning of nullity in Administrative Law. Clive Lewis, *Judicial Remedies in Public Law*, 5th ed., South Asia Edition (2017) in discussing the meaning of null and void in Administrative Law states (page 185):

> "The primary concern here is the meaning of nullity or voidness solely in the context of the remedies granted by courts. The concept of nullity has been used to solve other problem arising in administrative law. For remedial purposes, the orthodox view is that an ultra vires act is regarded as void and a nullity. An act by a public authority which

lacks legal authority is regarded as incapable of producing legal effects. **Once its illegality is established, and if the courts are prepared to grant a remedy**, the act will be regarded as void from its inception and retrospectively nullified in the sense that it will be regarded as ever incapable of ever producing legal effects." (emphasis added)

Thus, even where an act of a public authority is ultra vires and a nullity, for remedial purposes the illegality must be established before a court. As stated by Wade and Forsyth, *Administrative Law*, 9th Ed., Indian Edition, 281:

> "...the court will treat an administrative act or order invalid only if the right remedy is sought by the right person in the right proceedings"

Prior to *Mcfoy v. United Africa Co. Ltd.*(supra), this approach was reflected in the statement of Lord Radcliffe in *Smith v. East Elloe Rural District Council* [(1956) A.C. 736, 769-770] where he held:

> "An order, even if not made in good faith is still an act capable of legal consequences. It bears no brand of invalidity upon its forehead. Unless the necessary proceedings are taken at law to establish the cause of invalidity and to get it quashed or otherwise upset, it will remain as effective for its ostensible purpose as the most impeccable of orders."

In fact, Wade and Forsyth (supra page 305), states that the statement of Lord Denning in *Mcfoy v. United Africa Co. Ltd.*(supra) relied on by the Petitioner is not the correct position in law.

Wade and Forsyth, *Administrative Law*, (supra) page 304, after restating the above statement of Lord Radcliffe sets out the correct position as follows:

> "This must be equally true even where the 'brand of invalidity' is plainly visible for there also the order can effectively be resisted in law only by obtaining the decision of the court. **The necessity of recourse to the court has been pointed out repeatedly in the House of Lords and Privy Council, without distinction between patent and latent defects.** Lord Diplock spoke still more clearly [*F Hoffmann-La Roch and C AG v. Secretary for Trade and Industry* (1975) AC 295 at 366], saying that

> It leads to confusion to use such terms as 'voidable', 'voidable ab initio', 'void' or 'a nullity' as descriptive of the status of subordinate legislation alleged to be ultra vires for patent or for latent defects, before its validity has been pronounced on by a court of competent jurisdiction." (emphasis added)

This approach is consistent with the 'presumption of validity' according to which administrative action is presumed to be valid unless or until it is set aside by a court [*F Hoffmann-La Roche and Co. A G v. Secretary of State for Trade and Industry* (1975) AC 295]. However, this 'presumption of validity' exists pending a final decision by the court [Lord Hoffmann in *R v. Wicks* (1998) AC 92 at 115, Lords Irvine LC and Steyn in *Boddington v. British Transport Police* (1999) 2 AC 143 at 156 and 161, and 173-4].

This presumption applies to subordinate legislation as well. It is in this context that Lord Irvine LC in *Boddington v. British Transport Police* (1999) 2 AC 143 held:

> "The *Anisminic* decision established, contrary to previous thinking that there might be error of law within jurisdiction, that there was a single category of errors of law, all of which rendered decision ultra vires. No distinction is to be drawn between a patent (or substantive) error of law or a latent (procedural) error of law. An ultra vires act or subordinate legislation is unlawful simpliciter and, if the presumption in favour of its legality is overcome by a litigant before a court of competent jurisdiction, is of no legal effect whatsoever."

Therefore, I reject the submission made by the learned counsel for the Appellant that the determination of the TAC should be considered a nullity without any order of Court as to its invalidity as it was not made within the prescribed time period.

On the other hand, if the failure on the part of the TAC to adhere to the time limit should result in the aggrieved party obtaining the relief claimed, the legislature would have specifically stated so. For example, the second proviso to section 34(8) of the VAT Act specifically provides that "the appeal shall be deemed to have been allowed and the tax charged accordingly" where the

appeal to the Commissioner-General against an assessment made by the Assessor is not determined within the stipulated time of two years.

In *Mohideen's* case (supra), this Court concluded that the determination of the Board of Review was not time barred in terms of section 140(10) of Act No. 38 of 2000 as amended by section 52 of Act No. 37 of 2003. However, Court went on to state that "It would be different or invalid if the time period exceeded 2 years from the date of the oral hearing. If that be so it is time barred."

Rupert Cross in *Precedents in the English Law* (3rd Ed., 1977) offers the following formulations for *ratio decidendi* and *obiter dictum*:

> "The *ratio decidendi* of a case is any rule of law expressly or impliedly treated by the judge as a necessary step in reaching his conclusion, having regard to the line of reasoning adopted by him, or a necessary part of his direction to the jury" (page 76)
>
> "*Obiter dictum* is a proposition of law which does not form part of the ratio decidendi" (page 79)

We are of the view that the statement in *Mohideen's* case (supra) that the determination of the Board of Review is invalid if not made within the statutory time period is *obiter dicta*. Accordingly, we are of the view that the determination of the TAC in the instant case is not time barred. In *Kegalle Plantations PLC vs. Commissioner General of Inland Revenue* [CA (TAX) 09/2017, C.A.M. 04.09.2018] we arrived at a similar conclusion.

Question 2: New Ground

The learned counsel for the Appellant contended that the assessment which was issued on the Appellant was based on the letter dated 7th November 2003 and it was on the basis that the fertilizer subsidy received from the Government of Sri Lanka was liable to VAT. It was contended that this was the only ground until the matter was taken up before the TAC.

However, the Respondent had in the written submissions before the TAC presented an alternative submission with regard to the disallowance of the input credit. The learned Counsel for the Appellant contended that the Assessor as well as the Respondent had previously allowed the input credits and it was not open to the TAC to impose an additional liability by way of disallowing input credits.

In terms of in section 11A (6) of the TAC Act, any two or more judges of the Court of Appeal may *hear and determine any question of law arising on the stated case*.

The words "hear and determine any question of law arising on the stated case" first appeared in section 74(5) of the Income Tax Ordinance No 2 of 1932 which was interpreted by Basnayake C.J. in *R.M. Fernando v. Commissioner of Income Tax* (Reports of Ceylon Tax Cases, Vol. I, page 571 at 577) to mean that it requires the Court to hear and determine any questions of law arising on the stated case and not any question or questions formulated by the Board. Previously in *M.P. Silva v. Commissioner of Income Tax* (Reports of Ceylon Tax Cases, Vol. I, page 336 at 338) Canekeratne J. having considered section 74(5) of the Income Tax Ordinance No 2 of 1932 held that "all questions that could be raised on the whole case was intended to be left open". The learned Judge chose to follow the dicta in *Ushers Wiltshire Brewery v. Bruce* [(1915) A.C. 433 at 465,466].

In *Commissioner of Income Tax v. Saverimuttu Retty* (Reports of Ceylon Tax Cases, Vol. I, page 103 at 109) Abrahams C.J. did make a similar statement by stating:

> *"Incidentally there was no reference to us on this point by the Board of Review,* ***since that point was not put to the Board when they were called upon to adjudicate in appeal,*** *but* ***we are not, of course precluded from considering any point upon which the actual decision of the Board might be upheld, no matter what might have been their reasons for arriving at that decision****".* (Emphasis added)

It is an established rule of interpretation that the legislature is presumed to know the law, judicial decisions and general principles of law. *Bindra's Interpretation of Statutes*, 10th ed., page 235 states as follows:

> "The legislature must be presumed to know the course of the legislation, as well as the course of judicial decisions in the country, *a fortiorari* of the superior courts of the country. It is a well-settled rule of construction that when a statute is repealed and re-enacted, and words in the repealed statute are reproduced in the new statute, they should be interpreted in the sense which had been judicially put on them in the repealed Act, because the legislature is presumed to be acquainted with the construction which courts have put upon the words, when they repeat the same words, they must be taken to have accepted the interpretation put on them by the court as correctly reflecting the legislative mind."

When this Court is not precluded from considering any point on which the TAC determination may be upheld, irrespective of whether it was raised before the TAC, it matters not that a new ground to sustain the determination of the Assessor and the Respondent in appeal was raised before the TAC. It is observed that the Appellant was heard fully on the new ground raised by the Respondent.

Question 3: Input Credit

Question 2 deals with the procedural issue of disallowing input credit whereas question 3 deals with the substantive issue of disallowing input credit.

The learned counsel for the Appellant had a two-pronged approach to this issue. Firstly, he submitted that the Appellant is not caught up within section 22(3) of the VAT Act. Secondly, it was submitted that the entire system of VAT works on the premise that a supplier would be liable for output VAT on the supplies made by such person in the course of carrying on a taxable activity and such person would be entitled to input credit to the extent of the supplies which it has made.

The TAC determined that by virtue of subsection (3) of section 22 of the VAT Act, only so much of tax on the importation as is referable to the taxable activity on which tax can be levied shall be counted as input tax. Since the subsidy takes into account the total cost and the maximum selling price of the fertilizer the input tax credit attributable to the value of the subsidy cannot be allowed and as such the Appellant cannot claim 100% input tax credit.

However, the learned counsel for the Appellant submitted that the Appellant is only involved in the business of selling fertiliser and therefore it is clear that the entirety of the goods purchased by it are used for the purposes of a taxable activity on which tax is levied and in these circumstances section 22(3) of the VAT Act is inapplicable in relation to the claim of input credit by the Appellant.

It appears that the Appellant is seeking to have the best of both the worlds. On one hand it is contended that the Appellant is not making a taxable supply of goods or services at the time of receiving the subsidy. This is the reason why the TAC held that the subsidy granted by the Government in this case was not connected to a taxable supply and thus not liable for VAT. That activity of the Appellant is then a non-taxable activity in which case section 22(3) of the VAT Act becomes applicable.

Both learned Counsel have provided Court with a detailed explanation on how the VAT system works. The learned Counsel for the Appellant submitted that the entire system of VAT works on the premise that a supplier would be liable for output VAT on the supplies made by such person in the course of carrying on a taxable activity and such person would be entitled to input credit to the extent of the supplies which it has made and that if this chain of events is to be broken there must be specific words in the enactment which would indicate to the contrary.

The learned counsel for the Appellant further contended that if the input credit of the Appellant is not allowed the Inland Revenue Department will be charging an amount exceeding the tax paid by the final consumer.

He relied on the decision of the European Court of Justice in *Elida Gibbs Ltd. v. Commissioners of Customs and Excise* [Case No. C-317/94, Decided on 24.10.1996] where it was held (paragraph 19):

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

The decision in *Cape Brandy Syndicate v. CIR* [(1930) 12 TC 358] was cited where Justice Rowlatt held:

> "It means that in taxation you have to look simply at what is clearly said. There is no room for any intendment; there is no equity about a tax: there is no presumption as to a tax; you read nothing in; you imply nothing, but you look fairly at what is said clearly and that is the tax"

Nonetheless, the statutory provisions in the VAT Act are clear and must take precedence. Section 22(3) of the VAT Act is clearly applicable based on the argument made by the Appellant that the Government subsidy was not liable to VAT.

For all the foregoing reasons, Court answers the questions of law in the Stated Case as follows:

1. Is the determination made by the TAC dated 30th September 2014 a nullity in view of the determination not being made within the time limit specified in Section 10 of the Tax Appeals Commission Act No. 23 of 2011 (as amended)? **No.**

2. Is the TAC entitled to make a determination with regard to the disallowance of a claim of the Appellant for input tax credit in view of, **Yes**

    a. The assessments numbered 9823032, 9822336, 9822337 and. 98222338 not being issued on any such basis; and/or

    b. The Appellant not being granted an opportunity to appeal against the assessment on the basis of the disallowing of input tax credit; and/or

c. The Appellant nor the Assessor having adduced any such arguments in the hearings before the Commissioner General of Inland Revenue; and/or

d. The determination which has been made by the Commissioner General of Inland Revenue dated 19th January 2006 not making a determination with regard to the disallowing of input credit; and/or

e. The appeal which has been submitted by the Appellant against the determination made by the Commissioner General of Inland Revenue not being on the basis of any disallowing of input credit; and/or

f. The arguments being adduced by the Commissioner General of Inland Revenue before the Tax Appeals Commission at the latter stage of the hearings being directly in conflict with the basis on which assessments have been issued and appeals hereinbefore were conducted before the Commissioner General of Inland Revenue and Tax Appeals Commission

3. Is the determination made by the Tax Appeals Commission disallowing the claim of the Appellant (which has already been allowed by the Commissioner General of Inland Revenue) for input tax credit erroneous in law? **No.**

Accordingly, we confirm the assessment determined by the TAC.

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

Judge of the Court of Appeal

N. Bandula Karunarathna J.

I agree.

Judge of the Court of Appeal