COMMISSIONER OF INLAND REVENUE v GHIM LI FASHION (FIJI) PTE LTD

COURT OF APPEAL — CIVIL JURISDICTION

SIR KAPI, SMELLIE and HENRY JJA

9, 16 August 2002

[2002] FJCA 22

Taxation and revenue — goods and services tax (GST) — appeal — value added tax — insurance payments — Value Added Tax Decree 1991 ss 3(8), 15(1), 15(2), 65(4), 65(6), 65(7). — Companies Act — New Zealand Goods and Services Act 1985 s 5(13).

Ghim Li Fashion Pty Ltd (Respondent) was required to pay input tax and output tax. Respondent incurred losses from the destruction by fire of its factory. The Commissioner of Inland Revenue (Appellant) assessed VAT in respect of the insurance payment and purported to set-off against the Respondent's refunds the assessed VAT on the insurance payments. The High Court decided in favor of Respondent.

Held — VAT is not payable on the insurance payments received by the Respondent in respect of the destruction by fire of its factory. The intention of the Decree is to catch insurance payments for loss to any property if the loss occurred in the course of making a taxable supply. If it had been intended to confine to the operation of the deeming provision to a specific species of property, the legislation would have spelt that out. It applies to property which cannot be taxed as a supply. There can be no reason for giving the words other than their plain meaning and then applying the facts to that meaning. It is concluded that all the payments in question are deemed supplies under the Decree.

Appeal dismissed.

No cases referred to.

A. Bale for the Appellant

I. Fa for the Respondent

Judgment

Kapi PJ, Smellie and Henry JJA.

Introduction

This appeal arises out of consideration by the High Court of the provisions of Value Added Tax Decree 1991 (Decree).

The Respondent is a limited liability company duly incorporated in Fiji under the provisions of the Companies Act, and is engaged in the production and sale of clothing.

Under the provisions of the Decree, the Respondent was required to pay "input tax" on all items purchased in Fiji in the course of its business. In respect of all items sold from its business, the Respondent was required to pay "output tax". Because the goods sold from the Respondent's business were entered for export, they were zero rated for the purposes of Value Added Tax (VAT) under the second schedule to the Decree. The effect of this is that the Respondent pays output tax at zero percent. At the end of every tax period, the respondent files a return whereby it claims back all the "input tax" paid on goods and services purchased in Fiji.

For the period 1995–98 the Appellant assessed refunds to the Respondent in the sum of $334,355.54. However, a dispute arose between the parties as to the payment of this amount. Consequently, the Respondent issued a writ of summons claiming the refund of its VAT payments.

In its defence in the High Court, the Appellant claimed that the respondent owes VAT in respect of indemnity insurance payments received by the Respondent for the taxable period ending December 1995. The Appellant assessed VAT in respect of the insurance payment pursuant to s 3(8) of the Decree. Pursuant to s 65(4) and (6) the Appellant purported to set-off against the respondent's refunds the assessed VAT on the insurance payments.

It is not disputed that the Respondent suffered loss in relation to its business as a result of a fire at its factory in 1994. It recovered moneys under certain insurance policies for the following items:

Building	$798,382
Plant and Equipment	$1,457,583.60
Stock	$1,685,644.40
Loss of profit	$100,000
Vehicles	$42,801.74
Total	*$4,084,481.74*

The Appellant assessed VAT on the insurance payment at $350,125.59 (This calculation excluded the loss of profits.)

The trial judge considered the following issues:

(i) whether the VAT imposed by s 15(1) of the Decree is applicable to the insurance payment received by the Respondent under s 3(8) of the Decree; and

(ii) whether a notice of intention to set-off VAT was given by the Appellant in accordance with s 65(7) of the Decree.

On the first issue, the trial judge found that the insurance payments in respect of buildings, plant and equipment and motor vehicles did not relate to "loss incurred in respect of goods … in the course or furtherance of making taxable supplies". In respect of raw materials, he found that they were not goods which would otherwise have been the subject of supply in the course or furtherance of the taxable activity of the respondent. As to the stock intended for export, he found that it would have been zero rated under the second schedule to the Decree, and therefore not chargeable at the rate of 10 per cent.

In respect of the second issue, the trial judge found that the Appellant acted unlawfully in setting off the Respondent's account without first giving the required notice under s 65(6) and (7) of the Decree. Consequently, he gave judgment for the Respondent in the sum of $334,355.54 plus interest at the rate of 12-and-a-half per cent. This was the agreed amount of VAT set-off by the by the Appellant.

The Appellant has appealed against the decision on the interpretation and application of s 3(8) of the Decree. There is no appeal against the decision in respect of invalidity of the set off under s 65 of the Decree.

The central issue which has arisen for determination is whether, the trial judge correctly interpreted and applied s 3(8) of the Decree.

Section 3(8)

Section 3(8) provides:

Where under a contract of insurance, a registered person receives an amount by way of an indemnity payment relating to a loss incurred in respect of goods and services in the course or furtherance of making taxable supplies, that person shall, for the purposes of the application of this Decree to that person but not to the person by whom the payment is made, be deemed to have made a supply of goods and services to which the payment relates in the course or furtherance of the taxable activity, at the time when the payment is received, and the amount of the payment shall be deemed to be the consideration for that supply.

In the High Court Byrne J held that the subsection did not apply to the insurance payments received by the Respondent in respect of the loss of building, plant, motor vehicles and stock, in so far as the last mentioned comprised other than manufactured stock ready for sale. After examining the legislation, the judge concluded that s 3(8) was confined to receipts for goods which, had they not been lost would have been sold to create taxable supplies. He expressed the opinion that the subsection distinguished between a loss incurred in transactions which occur in course of carrying on the conduct of a business, and loss incurred in respect of the business itself. The judge emphasised the use of the term "taxable supplies" in that part of the subsection which identifies the subject matter of its provisions, and compared that with the term "taxable activity".

Construction of s 3(8) is critical to the issue of whether in the case of this Respondent the losses relating to the building, plant motor vehicles and stock are caught by its provisions.

To come within s 3(8) the loss under consideration must come within two qualifying provisions. First, it must be in respect of goods (or services). Goods are defined in s 2 as meaning all kinds of real and personal property, but not including choses in action or money. There can be no question that the buildings, the plant the vehicles and the stock in question are goods. It is not possible in our view to qualify that term in any way in s 3(8).

The second qualification is that the loss must have been incurred in the course of making or furthering taxable supplies — that is making or furthering a supply of goods charged with tax under s 15. The goods here are garments which have been manufactured by the Respondent. The course of making such goods must cover all aspects of the supply process — acquisition of materials, processing, manufacturing, handling, delivery, and everything through to (and including) the actual supply.

The losses now under discussion resulted from the destruction by fire of the Respondent's factory at Lautoka. It seems to us inescapable that those losses were incurred in the course of the Respondent's process of making garments for supply. There was a direct relationships between those losses, namely of buildings, plant, vehicles and stock all of which were undoubtedly used in the supply process we have identified for the purpose of achieving the intended end result, which was the sale of garments.

It is true that there is a distinction in the Decree between a taxable supply and a taxable activity. A taxable activity is one which involves the supply of goods for consideration (s 4(1)(a)). A taxable supply (s 2) is a supply of goods charged under s 15 — it is concerned with an actual supply as defined, whereas a taxable activity is concerned with what is an activity or business. But under s 3(8), we are concerned not with a simple taxable supply, but with what is encompassed in making or furthering that supply.

In the course of argument we were advised that s 3(8) was based on s 5(13) of the New Zealand Goods and Services Act 1985. It is couched in similar, but not identical, wording to s 3(8). As originally enacted, s 5(13) referred to losses incurred in the course of making a taxable supply. That was amended in 2000 to cover losses incurred in the course or furtherance of the registered person's taxable activity. It would appear that the amendment did not result from any judicial interpretation of s 5(13), but from a concern of the Commissioner of Inland Revenue that the original provision may be construed so as to exclude a loss resulting from for example, the destruction of a warehouse by arson. The concern apparently was that it could be argued that such a loss was not incurred in respect of making a taxable supply. The amendment was intended to overcome that potential result to ensure that output tax was paid on all insurance receipts other than those expressly excluded.

We are unable to see how the arson example would not have come within the original s 5(13), and also with s 3(8). For example if a factory containing machinery being used to manufacture goods for supply were to be the subject of a bomb attack as the factory was in the course of operation, the resulting loss of the factory itself and of the machinery surely would have been incurred in the course of the taxpayer making a supply of goods. The fact that it was a loss incurred in the course of carrying on a taxable activity does not mean it could not also be a loss incurred in the course of making a taxable supply. It may be that the phrase "loss incurred in the course or furtherance of a taxable activity" is wider than a loss incurred in the course or furtherance of a taxable supply, although the distinction is not on analysis easy to grasp. But the real issue is whether in these particular circumstances the loss in question was incurred in the course or furtherance of making a taxable supply. It is a matter of giving those qualifying words their ordinary and natural meaning. When that is done in the present case, we think it impossible to conclude these losses are excluded from the operation of s 3(8).

With respect, it seems to us that the judge's conclusion necessarily involves not an application of the facts to this qualifying provision — which he does not discuss — but a reading down or qualifying of the words "in respect of goods" so as to apply it only to goods which would have been supplied had it not been for the loss. The judge uses the qualifying phrase, wrongly in our respectful view, to qualify the term "goods". As he said:

> *The distinction upon which Section 3(8) seizes is the difference between loss incurred in the transactions which occur in the course of carrying on a business and loss incurred in respect of the business of the Plaintiff itself. The distinction is between losses in the conduct of the business and losses incurred in respect of the business itself. The operation of the deeming provisions of section 3(8) of the decree is thus enlivened by the receipt of payments by way of indemnity for losses in respect of what would otherwise have been the subject of taxable supplies by the Plaintiff, not losses in respect of the business structure of the taxpayer.*

And again:

> *I do not consider that Section 3(8) shows an intention to subject to VAT all insurance payments received in respect of a loss suffered in the course of the business carried on by a person engaged in a taxable activity. In my view its scope is obviously more limited as is shown by the fact that Section 3(8) is confined to receipts by way of indemnity for loss of goods which, had they not been lost, would have been sold so as to create taxable supplies.*

This line of reasoning occurs throughout the judgment. We do not think it possible to construe s 3(8) in this way. The provision clearly applies to any property which is the subject of loss, not just property which has already been converted into the form of a taxable supply. We do not think such a construction is justified by attempting to speculate on the rationale behind the provision. There is no ambiguity or uncertainty as to the meaning which requires recourse to other sources. In any event in our view to my mind it is far from clear that the intention was that encaptured by the above extract from the High Court judgment. Obviously that was not the intention of the New Zealand legislation. The intention we infer was, as the subsection states, to catch insurance payments for loss to any property if the loss occurred in the course of making a taxable supply. If it had been intended to confine the operation of the deeming provision to a specific species of property, the legislation would have spelt that out. In our respectful view, the fact that it applies to property which was not and would not have been itself a taxable supply can be no reason for giving the words other than their plain meaning, and then applying the facts to that meaning. We therefore conclude that all the payments in question are deemed supplies under s 3(8) of the Decree.

Zero rating

Having determined that the only goods which became subject to s 3(8) comprised manufactured stock ready for sale, the judge held that these were subject to tax but at 0% under s 15(2) of the Decree. The judgment in the High Court, which as in the case of the s 3(8) issue is a virtual repetition of the detail of the Respondent's submissions to that court, was based on identifying the taxable activity of the Respondent as being one which involved the supply of goods which were zero rated. The judge then proceeded to reason that because the deemed supply is also deemed to have occurred in the course or furtherance of the Respondent's taxable activity of supplying zero rated goods, s 15(2) came into operation. The deemed supply was of zero rated goods.

Under s 15(2) of the Decree a supply is charged at 0% where that supply is one described in the second schedule. It was not made clear during the course of this hearing which of those descriptions was said by the Appellant to be applicable. There was a brief reference to para 1, which covers goods entered for export and exported. The High Court judgment also contains a reference to the Respondent's taxable activity being the supply of goods entered for export as a condition of supply, which appears to be a reference to paragraph 4. Paragraph 4 contains a proviso to the effect that if the goods are not exported within 14 days of supply, the s 15(1) 10% tax will be charged.

Under s 3(8) the indemnity payment is deemed to be a supply of goods and services to which the payment relates. It is therefore necessary to necessary to identify the goods (or services) to which any particular payment relates. Applying the words of the subsection to the present facts, the Respondent received an indemnity payment in respect of manufactured stock. The payment is deemed to be a supply of stock, made at the time payment was received. The fictional transaction, which is equivalent to a sale of stock, was concluded at the time of payment. To bring s 15(2) into play, it would be necessary to go further and deem that stock to have been entered for export and exported. In fact the goods in question were at best intended for export, but never acquired the status of being zero rated.

In our view it is not possible to take the additional step. In effect the argument is that because the taxable activity is one which involves the supply of goods for export (zero rated goods), the goods to which the insurance payment related must be for goods for export. That consequence clearly does not follow. For example the position here is that the insurance payments related to goods (buildings, plant, vehicles) other than the stock, which could not possibly be given the status of goods for export, although the "supply" was deemed to be made in the course of the taxable activity of supplying zero rated goods. It again comes back to the plain meaning of the words of the subsection. There is a fictional supply of the lost or damaged goods taking place in Fiji at the time payment is received. Those goods are not in fact zero rated because they did not have the necessary status.

This result recognises the obvious intention behind s 3(8), which as we have earlier said is to catch insurance payments for loss to any property if the loss is incurred in the course of making a taxable supply. It can be compared with the disposition of a taxable activity as a going concern, which under s 3(12) is deemed to be a supply even though the taxable activity in question did not involve the supply of all the assets of the concern.

We therefore hold s 15(2) can have no application to any of the insurance payments now in question.

Conclusion

For the above reasons the appeal is allowed in so far as it determines that VAT is not payable on the insurance payments received by the Respondent in respect of the destruction by fire of its factory in Lautoka in September 1994. Leave is reserved to the parties to apply for a declaration to the effect that such payments are chargeable under s 15(1) of the Decree and s 15(2) has no application.

There being no appeal against the finding of invalidity of the set-off, the judgment in favour of the Respondent on that ground stands.

We were urged by counsel for the Appellant to comment on the language used by the trial judge in describing the nature and the reasonableness of the Decree. We do not consider that these matters arise out of the grounds of appeal for our consideration. Consequently it would not be proper to address them, but moreover we do not see this appeal as an appropriate forum to do so, and we propose not to comment. In saying that, we are not to be taken as in any way endorsing the judge's remarks.

In all the circumstances we make no order as to costs.

Appeal dismissed.