JAMAICA

NO. 13 of 1979

IN the Revenue Court - On the 31st day of May, and the 1st, 3rd, 7th, 8th and 9th days of June, 1982.

BETWEEN

CARRERAS GROUP LIMITED - APPELLANT

AND

THE COMMISSIONER OF INCOME TAX - RESPONDENT

For the Appellant: Mrs. A. C. Hudson-Phillips

For the Respondent: Messrs. H. A. Hamilton and L. Philpotts-Brown

NOTE OF ORAL JUDGEMENT

Although the arguments raised ranged over a wide area and I have heard testimony from a retinue of witnesses, I find that the case turns on one short point although a supplementary point may also arise. The crucial question is whether or not an organisation known as Tobacco Exporters International (hereinafter referred to as T.E.I.) was carrying on a trade in Jamaica through a permanent establishment. If that question is answered in the affirmative then certain tax consequences follow. If answered in the negative then the tax result is quite different.

2. Now, in order to fully understand this matter, it is necessary to state briefly some of the history surrounding the issue. I start first with the description of some of the personalities involved: Carreras of Jamaica Limited (hereinafter referred to as Carreras No. 1) set up business in Jamaica sometime in 1962 as a manufacturer of cigarettes under licence from the trademark owners. It continued to do so until the end of October, 1973, when the arrangements changed in the following manner: Carreras No. 1 changed its name to Carreras Group Limited (i.e. the Appellant) and, it ceased to manufacture cigarettes at the end of October, 1973, and became a holding company which held all the shares in a new company Carreras of Jamaica Limited (hereinafter referred to as Carreras No. 2). The manufacture of cigarettes which was previously carried on by Carreras No. 1 was taken over by Carreras No. 2, and the Appellant, as I have already said, became a holding company for not only Carreras No. 2 but also for two other companies; and from the 1st November, 1973 Carreras No. 2 performed the manufacturing

function formerly carried on by Carreras No. 1, now Carreras Group Limited. So much for the personalities.

3. Next in order of importance is the fact that sometime in 1975, the Respondent Commissioner undertook a field audit of the cigarette manufacturing operation situated at Twickenham Park in Spahish Town in Saint Catherine. As a consequence of that audit and based on information available to the Respondent Commissioner from the records available to him, the Respondent Commissioner took the view -

(1) that royalties were being credited to the account of a U.K. company - Carreras Rothmans Limited; and

(2) that a sum described as "net proceeds" derived from the sale of cigarettes in the Eastern Caribbean was also being credited to the account of Carreras Rothmans Limited.

On that basis, the Respondent Commissioner took the view that Carreras Rothmans Limited was carrying on a trade through a permanent establishment in Jamaica, and consequently, that the preferential rates of tax provided for in the Jamaica/UK Double Tax Treaty - (which is to be found in the Jamaica Gazette Supplement 1973 No. 140) no longer applied to it; and so he proceeded to assess that company through the Appellant, on the combined profits consisting of the royalties and "net proceeds" at the standard rate of 45 percent. It is that assessment which has given rise to these proceedings.

4. In due course, objections were filed in accordance with the provisions of the Income Tax Act and apparently there were meetings and correspondence between the parties. At one of those meetings or in one of those letters exhibited to the case, the company pointed out to the Respondent that in fact the so-called "net proceeds" which had been credited to Carreras Rothmans were in fact destined for T.E.I. and requested that the assessments be amended on the basis that the profits did not belong to Carreras Rothmans Limited but to T.E.I. and that in any event T.E.I. was not trading through a permanent establishment, and so, was protected by the Jamaica/UK Double Tax Treaty.

5. The next stage in the proceedings was that the Respondent wrote to the Appellant on Janaury 13, 1977, requesting it to furnish information to substantiate its claim that the net proceeds credited to the account of Carreras Rothmans Limited was properly attributable to T.E.I. The Appellant, in the person of Mr. Saulter who was chief executive officer at the time, replied within ten (10) days promising to supply the information and indicated that some of it had to be obtained from the U.K. Strangely, however, for reasons which have never been explained until the matter came up in this Court, the Appellant failed to follow through on its undertaking to supply the information and, as a consequence, some time in October 1979 the Respondent Commissioner issued a Notice of Decision confirming the Assessments on the basis that royalties and "net proceeds" were all attributable to a trade being carried on in Jamaica through a permanent establishment, by a non-resident. It is that Decision which is now on appeal before this Court. I add for completeness, that there is a slight hiatus in the facts because it was discovered that Carreras No. 1 had changed its name to Carreras Group Limited and as a result the Respondent submitted new notices in that name to regularise the position. I must also add that income tax returns supported by accounts were submitted to the Respondent in respect of the Years of Assessment under review, viz, 1973 and 1974.

6. In this Court, a number of witnesses were called by the Appellant and the burden of their evidence was as follows:-

(1) To substantiate that Carreras No. 1 had changed its name to Carreras Group Limited;

(2) That Carreras Group Limited had ceased manufacturing cigarettes from 31st October, 1973, and;

(3) That Carreras No. 2 commenced to manufacture cigarettes on November 1, 1973, until some time in 1977 when there was a merger between Carreras No. 2 and another company known as B. & J. B. Machado under the new name of The Cigarette Company of Jamaica Limited.

7. Evidence was also led in an effort to explain the precise nature of the arrangements under which the net proceeds from Carifta sales were being credited to Carreras Rothmans for the benefit of

T.E.I. Some of that evidence established the following--

(1) T.E.I. was a subsidiary of Rothmans International and so was Carreras Rothmans Limited;

(2) Carreras Rothmans Limited was, under a licencing agreement, entitled to the use of certain trade-marks and to the payment of royalties for the same;

(3) Carreras Group Limited was partly owned by Carreras Rothmans Limited but the latter was not the majority shareholder as it held only 48 percent of the shares whereas the other 52 percent remained in Jamaican hands.

(4) T.E.I. had a marketing arrangement in the Eastern Caribbean for the marketing of certain brands of cigarettes. The organisation from time to time secured purchasers in the Eastern Caribbean and in pursuance of meeting those demands of its customers it entered into an arrangement with Carreras No. 1 & 2 whereby cigarettes would be manufactured in Jamaica to the order of T.E.I., then shipped to the Eastern Caribbean and in due course the proceeds of the sale would be remitted to Carreras No. 2 who would deduct therefrom its manufacturing cost based partly on a fixed sum of £10,000, and partly, on the overheads involved in the manufacturing of cigarettes for T.E.I. and designed to fluctuate on the volume of cigarettes produced. The balance - the net proceeds - was then credited to Carreras Rothmans Limited for T.E.I. by the Jamaican Company.

The witnesses, explained that this was an accounting convenience whereby all payments to any of the U.K. companies were funnelled through the Carreras Rothmans account and payment to Jamaica through Carreras Group Limited. Further the evidence was that the local companies were not obliged to fill orders for T.E,I. and that in fact the arrangement adopted between itself and T.E.I., was a common practice of international tobacco traders of ordering cigarettes from a manufacturing source which was closest to the target market; and that this concept was known as "sourcing".

8. One more item of evidence was the method used in filling

orders -

(1) the evidence was that cigarettes were manufactured to the order of T.E.I. and were separately and specially packaged;

(2) the local company never kept in its warehouse in Jamaica a stock from which orders were filled;

(3) each order was manufactured and then passed through the Government Excise Warehouse for export to the Eastern Caribbean. Throughout the entire operation cigarettes remained the property of the local company until put on board the ship for the Eastern Caribbean;

(4) the local company was not obliged to supply the cigarettes even though it did in fact supply them.

I have already indicated that the evidence is that neither T.E.I., Carreras Rothmans nor Rothmans International had any controlling interest in any of the local companies.

9. Finally, the evidence was that T.E.I. did not maintain in Jamaica a factory, office, branch, workshop, warehouse, place of management, etc. This evidence was led in an effort to establish that T.E.I. had no fixed place of business in Jamaica, in the context of that expression as used in Article 4 of the Treaty, in which the expression permanent establishment is defined - that, I think, summarises the most cogent aspects of the evidence led before me.

10. The Respondent, as he was entitled to do, decided not to lead any evidence and the result therefore is that the only evidence before me is that led in support of the Appellant's case. Before I express my findings on that evidence - I wish to say something about it because it maybe important. The bulk of the evidence led (with the single exception of the bald allegation made initially by the Appellant that the net proceeds belonged to T.E.I.) was never presented to the Respondent Commissioner. I am referring to the whole of the evidence relating to the arrangements between T.E.I. and the local companies and how orders were filled; and the evidence relating to the question of permanent establishment. On the quality of the evidence itself, I think all the witnesses

were highly qualified or very experienced, and collectively, had a working experience of some twenty years with the local companies going back to the year 1962 when they were first set up. They all impressed me as witnesses of truth and reliability and their testimony was not shaken in any material respect by cross examination. I therefore accept the evidence as it applies to the nature of the arrangements between T. E.I. and the local companies and, on the question (which is one of mixed fact and law) as to the existence in Jamaica of a permanent establishment for T.E.I.

11. So much then, for the evidence. I turn now to a determination of the main question, namely, was T.E.I. carrying on a trade in Jamaica through a permanent establishment within the meaning of Article 4 and 5 of the Treaty? In this connection Counsel for the Respondent made a strong and incisive submission in an effort to satisfy me that the overseas company, at any rate in the relevant Years of Assessment, did in fact carry on a trade in Jamaica through a permanent establishment. In this he rested his case partly on the undisputed evidence led by the Appellant as to the particular arrangement which existed between T.E.I. and the local companies, and I refer, of course, to the following -

(1) the fact that cigarettes of various brands were manufactured in Jamaica at the specific request of T.E.I.;

(2) that after manufacture, they were shipped to Caricom;

(3) payments from those customers were received by the Jamaican companies;

(4) from those payments, Jamaican companies deducted certain agreed amounts as set out in Exhibit 17, remitting the balance to Carreras Rothmans through the inter-company account.

12. Counsel submitted that, on that view of the facts, it was clear that profits accruing to T.E.I. arose in substance from the said activities. He cited in support Section 5 (3) of the Income Tax Act, the Firestone case 37 T.C. p. 111 and Greenwood v Smith 8 T. C. 135. Counsel also invited the Court's attention to a work

known as "International Tax Treaty Service" edited by Mr. Micheal Edwards-Ker and published by the In-Depth Publishing Company. This is a work which, I gather from Counsel, was prepared either, on the authority of, or in conjunction with, the Organisation for Economic Co-operation and Development (O.E.C.D). In it there is a chapter which sets out the common form draft followed in most treaties involving a permanent establishment, as well as a commentary thereon. I shall return to these later.

In our treaty - the Jamaica/UK Treaty - Article 4 states as follows:

> 'For purposes of this Agreement the term "permanent establishment" means a fixed place of business in which the business of the enterprise is wholly or partly carried on.'
>
> Paragraph 2 of Article 4 states --
>
> 'The term "permanent establishment" shall include especially:
>
> (a) a place of management
> (b) a branch;
> (c) an office;
> (d) a factory;
> (e) a workshop;
> (f) premises used as a sales outlet;
> (g) a warehouse, in relation to a person providing storage facilities for others;
> (h) a mine, quarry or other place of extraction of natural resources;
> (i) a building site or construction assembly project which exists for more than six months'.

Thus this paragraph provides a specific calender of activities beginning at (a) and ending at (i) which are deemed specifically to constitute a permanent establishment.

> Paragraph 3 of Article 4 states -
>
> 'The term "permanent establishment" shall not be deemed to include:
>
> (a) the use of facilities solely for the purpose of storage, display or delivery of goods or merchandise belonging to the enterprise;
>
> (b) the maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of storage, display or delivery;
>
> (c) the maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of processing by another;
>
> (d) the maintenance of a fixed place of business solely for the purpose of advertising, for the supply of information, for scientific research or for similar activities which have a prepatory or auxiliary character, for the enterprise."

Paragraph 4 of Article 4 is not relevant -- Paragraph 5 of Article 4

is relevant and, it states -

> "A person acting in one of the territories on behalf of an enterprise of the other territory - other than an agent of an independent status to whom paragraph (7) applies - shall be deemed to be a permanent establishment of the enterprise in the first-mentioned territory:-
>
> (a) If he has and habitually exercises in that territory, an authority to conclude contracts in the name of the enterprise, unless his activities are limited to the purchase of goods and merchandise for the enterprise;
>
> (b) if he maintains in the first-mentioned territory a stock of goods or merchandise belonging to the enterprise from which he habitually fills orders or makes deliveries on behalf of the enterprise."

So much for the statutory provisions.

13. The evidence indicates that there was no stock of goods belongir to T.E.I. from which the Jamaican company habitually filled orders, and similarly, the fact is that the local company did not have and did not exercise, habitually or otherwise, any authority to conclude contracts in the name of T.E.I. Nor could it be said that the premise owned by the Appellant were being used by T.E.I. as a "sales outlet"; since the evidence is that the Appellant was not obliged to fill order as well as the fact that the stock of cigarettes manufactured by the Appellant remained its own property until put on board ship.

14. Faced with this evidence, Counsel for the Respondent submitted that the expression "place of business" as used in the Treaty covered, any premises, facility, or installation used for carrying on the business of the enterprise whether or not they are used exclusively for the purpose. It was immaterial, so the argument ran, whether the premises, facility or installation were owned or rented by, or otherwise at, the <u>disposal</u> of the enterprise; in fact it may be even in the business facilities within another enterprise e.g. <u>where it has at its constant disposal certain premises or part thereof owned by the other enterprise.</u> I stress the last phrase - because if I understand the argument correctly - the suggestion was that this is the position in the instant case, in that the local company manufactures cigarettes at and to the specific order of T.E.I., together with the arrangement for shipping, packaging, and payment for these services. Counsel submitted that this meant that T.E.I. had at its <u>constant</u> disposal, premises or at the worst, <u>part of</u> premises, and was therefore conducting a trade or business through a fixed place of business, which in terms of the Treaty would mean

mean that it had a permanent establishment here.

15. I do not, with respect, see how this could be a proper view of the facts. The premises owned by the Appellant were at its own disposal in the conduct of its own business. It seems to me that to say they were at the 'disposal' of T.E.I. is tantamount to saying that all business premises are at the 'disposal' of customers rather than their owners. A concept which, if true in a general sense, seems far too wide to fall within the Treaty; I say this because if, for example, an overseas firm that falls within the treaty, purchased, let us say an automobile tyre from a local firm, then on such a wide construction, it would run foul of the Treaty on the ground that the tyre dealer's shop, was a 'facility' which was at its 'disposal'.

16. Nevertheless, it was urged upon me that such a view reflects the modern trend in tax Treaties, where developing countries are forever seeking to extend the meaning of 'permanent establishment' so as to protect themselves from foreign fiscal exploitation. That such a trend exists might well be true, but whether it has gone as far as Counsel suggestes, seems to me, to be in doubt. Apart from the aforesaid Commentary, no authority was cited in support of this proposition. Interestingly enough the commentary on Article 5 in the International Tax Treaty Service - more precisely the commentary on Article 5, paragraph 1 - in which the definition of permanent establishment is given, would seem to suggest that the matter has not infact gone as far as Counsel suggested. That commentary reads in part as follows:

> "Paragraph 1 gives a general definition of the term 'permanent establishment' which brings out its essential characteristics as a permanent establishment in the sense of the Convention i.e, a distinct "situs", a "fixed place of business". The paragraph defines the term "permanent establishment" as a fixed place of business, through which the business of the enterprise is wholly or partly carried on. This definition, therefore, contains the following conditions:
>
> - the existence of a 'place of business' i.e, a facility such as premises or, in certain instances, machinery or equipment;
>
> - this place of business must be 'fixed' i.e, it must be established at a distinct place with a certain degree of permanence;
>
> - the carrying on of the business of the enterprise through this fixed place of business. This means usually that persons who, in one way or another, <u>are dependent on the</u>

enterprise (personnel) conduct the business of the enterprise in the State in which the fixed place is situated".

17. Even if, therefore, one accepted for purposes of argument that the arrangement between T.E.I. and the local company could be brought within Counsel's suggestion - that is - there was a "facility" in Jamaica at the "disposal" of T.E.I. I do not see how that could be sufficient to dispose of the matter in the Respondent's favour, because the wording of the commentary clearly anticipates that apart from the mere existence of a facility, there must also be some element of inter-facing between resident and non resident personnel. There is in my opinion, no one in the local company who is "dependent" on T.E.I in that sense. The uncontradicted evidence is that neither T.E.I. nor its holding company has any controlling interest in the local company, and all arrangements are at arms length. The system for the manufacture of cigarettes locally, including the arrangement for shipp and payment, do not in my judgement render any of the Jamaican companies dependent on T.E.I. any more than in the general sense of any business being dependent on its customers. As one of the witnesse said, the Appellant is not obliged to execute these arrangements - although it did in fact do so on a regular basis, largely because it was (1) good business and (2) part of the practice of "SOURCING" utilized by international tobacco traders.

18. Counsel in an effort to overcome this difficulty, suggested tha the use of the word "usually" in the commentary, meant that the concept of dependence or inter-facing of personnel referred to was not exhaustive of the matter. I do not agree. In my opinion the passage cited, notwithstanding use of the word "usually", is more in keeping with established practice and with the widely held view, that, the predominant meaning of "permanent establishment" in such Treaties involves some organisation or arrangement where there is a 'presence', in one form or another, of the overseas organisation in the country of taxation. In any event the International Tax Treaty Service, while serving as a useful guide for draftsmen of Tax Treaties, is not in any sense a binding authority on this Court.

19. In all cases of this nature it is a question of degree whether or not such a "presence" exists; and the answer must turn upon an

analysis of the particular facts. The instant case is no exception. While therefore, it may be said that the arrangements involving T.E.I. are close to the bone, they are not, in my judgement, close enough to scrape it. On this point therefore, I find for the Appellant and hold that there is no justification in law for taxing the so-called "net proceeds" outside of the Treaty.

20. I turn now to the question of royalties: the evidence is that Carreras Rothmans is entitled to the use of the trademark under a user agreement between itself and the trademark owners. In such circumstances, it is clear and undisputed, that Carreras Rothmans is to be assessed in Jamaica for those royalties at the rate of 10 percent as provided for by the Treaty.

21. That leaves only one aspect of the case - that is - the question of splitting the assessment. However, my finding that there is in this case no permanent establishment would seem to dispose of the point because, if the profits are not assessable on T.E.I. then there is no longer any need to decide whether the assessment should be split. There is to be one assessment on the Appellant, and at the rate of tax specified in the Treaty.

22. At the end of the day then, the result is that the appeal is allowed.

23. However, before leaving this matter I wish to make an observation and it is this. Although the Appellant had to come to this court to have its assessment varied, this was due largely to its own laches in dealing with the matter when it was before the Respondent Commissioner for his decision on the objection. None of the evidence or arguments presented in this Court were such as could not have been raised in the proceedings below. This is particularly true of the explanations for the difficulty or, inability, of the Appellant in obtaining the information requested by the Respondent. For these reasons I have come to the conclusion that the costs incurred by the Appellant in coming here, were due in a large measure, to the cavalier fashion in which reasonable requests from the Respondent Commissioner were treated. Accordingly, the Appeal is allowed but there will be no order as to costs.

NO. 12 of 1979

BETWEEN

CARRERAS GROUP LIMITED - APPELLANT

THE COMMISSIONER OF INCOME TAX - RESPONDENT

Approved,

Dermot Marsh

Judge of the Supreme Court
and of the Revenue Court.