IN THE COURT OF APPEAL
APPELLATE JURISDICTION

Civil Appeal No. ABU 035 of 2010

BETWEEN	:	**VERGNET SA**
		Appellant
AND	:	**THE COMMISSIONER OF INLAND REVENUE**
		Respondent
Coram	:	Chandra JA Lecamwasam JA Balapatabendi JA
Counsel	:	Ms. R.K. Naidu and Ms. S. Basawaiya for Appellant Ms. F. Gavidi and Ms. T. Rayawa for Respondent
Date of Hearing	:	18 February 2013
Date of Judgment	:	30 May 2013

JUDGMENT

[1] This appeal is against the judgment of the learned High Court judge of Suva dated 16th July 2010 which refused to grant the reliefs sought in the originating summons dated 11 July 2008. The appellant, Vergnet SA is a foreign company incorporated in France and registered under section 367 of the Companies Act in Fiji. Vergnet SA leads the world market for the development and manufacture of equipment and power generation and water supply in rural and isolated sites.

[2] The appellant entered into an agreement with the Fiji Electricity Authority (FEA) on 8 July 2005 to design, manufacture, construct, install, commission, test, operate, and complete a wind farm at Butoni, Sigatoka. The agreement was described as a Turnkey contract. The appellant contends that a 'Turnkey Contract' refers to an agreement where the purchaser contracts to have delivered the end product that requires the purchaser to simply 'turn a key' and start using the product. The respondent does not agree with this definition. Apart from the main contract document there were other relevant documents such as Memorandum of Understanding (MOU), Deed of Confidentiality, meeting report, and Principal's letter of acceptance, etc.

[3] In the instant case the payment is made by FEA to Vergnet SA. The Non Resident Miscellaneous Withholding Tax (NRMWT) is charged under section 8A of the Income Tax Act on the making of the payment. If the payment is in respect of know-how or for management or supervision then the FEA is responsible for deducting the tax in respect of such.

[4] When the Commissioner of Inland Revenue (the respondent) imposed an NRMW Tax of F$874,496.41 on the appellant, Vergnet SA the appellant filed action in the High Court challenging the imposition of the above tax and sought the following reliefs:

1. **A Declaration that payments made to Vergnet SA by the Fiji Electricity Authority (FEA) under a contract between Vergnet SA and FEA dated 8 July 2005 (Contract) are not subject to:**

a) Non-resident miscellaneous withholding tax (NRMWT) under section 8A of the Income Tax Act, or

b) Royalty withholding tax (RWT) under section 10A of the Income Tax Act.

2. A Declaration that the action taken by the Commissioner:

a) In assessing Vergent SA to NRMWT of F$874,496.41 and

b) Requiring the payment of the above sum by FEA before issuing a tax clearance certificate to FEA to remit the proceeds of payment under the Contract were:

c) In breach of section 8A and 10A of the Income Tax Act and unlawful and/or

d) Not otherwise in accordance with the Income Tax Act

3. An order that all sums paid to the Defendant as NRMWT by or on behalf of the Plaintiff be refunded to it, with interest.

[5] In the course of construction a controversy arose as to the taxes payable in Fiji and one of those related to the payment of Non Resident Miscellaneous Withholding Tax. The appellant's position was that under the contract the appellant did not impart any 'Scientific, technical, commercial, or industrial information, techniques, knowledge, or assistance likely to assist in the carrying on of a business' to the FEA. Further, the appellant contended that the appellant supplied a completed or installed product in the form of a wind farm package consisting of Wind Turbine Generators and other allied equipment and services (ex: design, packing, installation) and therefore the appellant's position is that none of the said services supplied, constituted the acquisition of know-how and consequently there was no and could not have existed any know-how payment made by FEA under the contract.

[6] On the other hand, the respondent asserts that the payment was in relation to a service provided which goes beyond the simple supplying and installation of turbines. He claims that the contractual material shows that the said payment relate to elements of the definition of know-how and further states that the contract provided for design and supervision services and supply of confidential information, drawings, data, reports, calculations, and test certificates. Moreover the contract further provided for training by Vergnet for the

benefit of the FEA staff. The position of the defendant is that the cumulative effect of all these factors provides overwhelming evidence of acquisition of know-how by the FEA.

[7] Section 2 (1) of Income Tax Act defines know-how payment as "a payment for any scientific, technical, commercial or industrial information, techniques, knowledge, or assistance likely to assist in the carrying on of a business …" The learned High Court judge (HCJ) had dealt very extensively with the relevant clauses in various documents pertaining to the contract and having considered those clauses and other relevant facts had arrived at the conclusion that the payment made by FEA included a payment for knowledge and information of sufficient technical nature to constitute a payment for know-how. In the last paragraph on page 15 of his judgment the learned HCJ states thus: "It is obvious that a mechanical device such as a Wind Turbine Generator could reveal its workings to any qualified technician employed by FEA once delivered and during installation. Such information could be derived by studying the technical information provided by the plaintiff and by physical examination during assembly and installation. What might also be detectable by such a person from these same sources was the process of manufacture of its component parts. In both cases, know-how has been acquired by FEA."

[8] I hesitate to agree with the learned HCJ when he says "such information could be derived by studying the technical information provided by the plaintiff and by physical examination during assembly and installation." The entirety that would have been available at the time of assembly or installation could have been finished parts of the wind turbines and other equipment. In such a situation it is my opinion that it would not be possible for any technician to acquire a fair knowledge of the workings during assembly and installation. Even if technicians have some pre- existing knowledge it cannot be sufficient knowledge and it cannot exceed anything more than the "dribs and drabs" of knowledge as the appellant pointed out.

[9] One might be able to get some scanty knowledge during the process of assembly and installation, but the fact this court has to ascertain is whether there is any payment in respect of such acquisition of knowledge. Surely with this type of knowledge one cannot construct another wind farm. Nowhere in the contract is there provision for payment in regard to acquisition of knowledge based on assembly or installation. On the contrary (under Schedules 5.15 and 5.18 – pages 86 and 89) there is provision for payment for training. A cohesive reading of Schedule 5.15 (training programme) and Schedule 5.18 (operations and maintenance) points to the obvious fact that there is an agreed price for operations and maintenance whereas there is no such price in respect to assembly and installation. Therefore although a certain payment is involved in respect to operations and maintenance there is none in relation to assembly and installation. Although the learned HCJ concluded that information could be derived by studying the technical information provided by the plaintiff (appellant) and by physical examination during assembly and installation in my view such information is very much limited and even if there is such information, as a payment is not involved the appellant cannot be held liable for NRMW Tax under know-how.

[10] As per Schedule 5.4 payment and Advanced payment guarantee, the goods are delivered to Fiji only at the end of stage 4 enumerated in the said schedule. Until such time the main components are in the possession of the manufacturers. Except for two items most of the main components are manufactured in France. As per Schedule 5.5 the Principal or the Principal's representative has the right to inspect all of the major components of the WTG during its manufacture. When the Principal is satisfied that a representative sample of the components of the WTG have been satisfactorily inspected the contractor may issue a Factory Test Certificate (FTC) for that WTG. The contractor will make any changes to the WTG arising out of the inspection process … Principal shall be fully responsible for the cost and expense of lodging, air transportation, meals and any and all other expenses.

[11] The above schedule illustrates the right of the Principal to inspect the major components during manufacture and to advise the contractor to make necessary changes upon inspection. It is clear that these inspections are done when the major components are with the manufacturers in the country of its origin. The fact that the Principal is responsible for cost and expense of lodging, air transportation, meals and any and all other expenses makes it obvious that the Principal or his representatives have to travel to France from Fiji where the components of the project are. As their purpose of travelling is to carry out inspection and advise the manufacturers in France to do changes if necessary, there is no doubt that this team must be possessed of knowledge on par with the French manufacturers or even better knowledge than them if they are to carryout inspections and advice the French contractors. Therefore the question of acquisition of knowledge becomes redundant. As the visit of the inspection team is to inspect and not to learn or for training, there cannot be any acquisition of know-how from French contractors.

[12] Apart from these inspection tours there is no evidence before court to show that any other personnel from FEA have visited France for training or for any other matter connected with the wind farm project. In short, up to the time of manufacture and delivery of each partial shipment {DDU Fiji (incoterms2000) as per shipping schedule} i.e. up to the time of completion of stage 4 (5.4.1 payment schedule) there is no evidence or any provision in the contract to show that anyone has visited France in connection with the wind farm project with the exception of the inspection team. Therefore until the completion of stage 4 i.e. until the delivery in Fiji of approximately 150 shipping packages containing various manufactured project items it was not possible for anyone from FEA to acquire any know-how because they did not have the opportunity to do so. Hence acquisition of any know-how from manufactured articles is not a possibility.

[13] I beg to disagree with the learned HCJ when he states on page 15 in his judgment "what might also be detectable by such a person from these same sources was the process of manufacture of its component parts." Manufacturing items like WTG nacelle, hub,

internal equipment, WTG control equipment, sensors, blades, tower assemblies, gin pole, winch, grid control panel, elevator, etc. is undoubtedly a sophisticated technological process. These processes take a long period of time and use of modern scientific methods and equipment for the manufacture of above articles and hence even qualified technicians may not be equipped to grasp the intricacies of wind farm project items with a superficial view of any of those items. In my view the mechanism or even a minuscule part of it cannot be understood by a person in the process of assembly or installation. One may acquire an idea about the outward appearance of an item but certainly not the process of manufacturing of component parts.

[14] On perusing the contract and the material involved in the wind farm project it would appear that the whole project comprises a high degree of know-how. It is true that know-how plays a vital role in any manufacturing process even of the rudimentary variety. When the project is of this magnitude, needless to say, it not only contains know-how but the whole project is saturated with know-how and perhaps overflowing with know-how. But the mere presence of know-how in a product does not make it taxable. The know-how or knowledge must be acquired by another person and there ought to exist a corresponding payment for such acquisition. Then and only then will such payment be liable for taxation under section 8A.

[15] In the instant case I do not see any acquisition of know-how up to the time of manufacture and until the completion of stage 4. As per schedule 5.4 (payment) it is evident that stages 1-4 consume 72% of the contract price.

The training programme envisaged in schedule 5.15 relates to the maintenance of the equipment and operations of the units only. In Schedule 5.18, under operations and maintenance, a breakdown is provided which covers a period of 3 years. The importance in this training programme is that, as mentioned earlier, it confines to maintenance and operations only. It is apparent that this arrangement does not cover any period before commissioning. Although a training programme can impart know-how to a certain extent,

it is important to remember that it covers only the commissioning and post-commissioning period. The learned HCJ also had attributed training as one of the factors of acquisition of know-how. Even if there is acquisition of know-how it cannot be included into the 15% of NRMW Tax out of a 30% service component, as the operation and maintenance costs are excluded from the main price (per pages 57 and 65). The respondent, when calculating the 15% of NRMW Tax, had based his calculations on the main price. I have already pointed out that as operations and maintenance costs are excluded from the main price, naturally any payment in connection with training should also be excluded and not be taken into consideration. Hence the items excluded from the main price could not have been taken into consideration when the respondent calculated 15% NRMW Tax based on the main price.

[16] Under conditions of contract – part II (in page 00113) under the sub-heading "Substantial Completion", clause (e) provides thus: "The contractor has supplied to the employer all drawings (except as built drawings), specifications, calculations, test data, performance data, equipment descriptions, equipment and system installation instruction manuals, spare parts lists, training manuals, operation and maintenance manuals, data, instruction books, license agreements required to be provided pursuant to sub clause 1.10, other technical information required by the employer's requirements and such other information as is required for the employer to **start-up, operate and maintain the works."**

[17] A careful reading of clause (e) makes it clear that all these drawings, specifications, calculations … etc. are items required for the employer (FEA) to "*start-up, operate and maintain the works"* (Emphasis added). Again all these things are also categorized under "operations and maintenance". As stated earlier even if there is acquisition of know-how on the above mentioned items, any payment on those items cannot be taken into account, as operations and maintenance costs are excluded from the main price. The respondent had calculated the tax of F$874,496.41 on the main price of €11,542,030. Therefore any

acquisition of know-how and resulting payment of tax on the basis of the above items must also be excluded.

[18] The respondent cited a number of cases in support of his position. The cases of *Ricketts, J100* (1987) 9 NZTC, *Australian tax ruling* IT 2660, *FCT* vs. *Sherritt Gorden mines* and *Rapistan Canada Ltd.* vs. *Minister of National Revenue,* were cited in support of an explanation on what is know-how under different situations. But in the instant case it is not disputed that the whole project is composed of know-how to a great extent, but the question is whether the payment comprised a payment for know-how or whether it is for the finished product of the wind farm. On the other hand the appellant relied on Rolls Royce and Evans decisions. In Rolls Royce and Evans the concept of know-how was gone into and they were situations where the contracts involve know-how. In the Rolls Royce case know-how was not considered to be passed on, while in Evans case it was passed onto the buyer of the product. In both instances know-how was considered to be the skills, the designs and the processes involve in the manufacturing of the product.

[19] The Deed relating to confidential information outlines the obligations of each party in relation to the use and disclosure of confidential information more or less on an exchange basis and it does not reveal any payment. Confidential information is not confined to know-how alone and it can include other matters of a confidential nature connected to the trade and not available in the public domain such as monetary references, internal policies etc. Hence, up to the stages of commissioning and substantial completion, parties have acted on the strength of 'The Turnkey Contract' they have initially entered into. Not only was the essence of the contract a turnkey contract to deliver a finished product in the form of a wind farm package, but it in fact delivered a finished product. According to the contractual documents before court, it is obvious that Vergnet SA agreed for the supply and installation of a 10.175 MW (37 WTGs) wind farm at Butoni, Sigatoka. Logically it is evident that without know-how it is impossible to bring forth a wind farm. It maybe because of this know-how, skill and expertise that the FEA had awarded the contract to

the appellant, but the price agreed was for the finished product of the wind farm. If one delves into the various aspects of the project, one can see such elements as different mechanisms and machinery involved in manufacture and post-manufacture stages, during shipping and transport, assembly and installation, etc. But the appellant has bundled all these elements into one finished product called a 'wind farm' and quoted a price for the whole package to which the FEA agreed.

[20] Accordingly it is not reasonable for the respondent to sub divide the package offered and agreed upon by the parties and levy taxes on each component. Otherwise it will be akin - if I may draw a parallel here with the manufacturing of a car - to taxing the finished product of a car on the basis of various components of the car such as the gear shaft, steering wheel, carburetor, engine, etc. Such subdivision will not only dissuade foreign investors in investing in Fiji ventures but will in turn have detrimental effect on the national economy of Fiji.

[21] However there is another matter which requires the attention of court i.e. the management or supervision aspect found in Section 8A (2b). The above section reads as follows:

> *"(b) Subject to sub-section 4, a know-how payment and any sum paid or credited for the management of or supervision in connection with the carrying on of a business".*

[22] According to the above provision 'any sum paid or credited for the management or supervision in connection with the carrying on of a business' is also taxable under 8A (2b). I find (in page 00065) that there is provision for the principal to strike separate contracts with sub contractors and out of that amount, the contractor (appellant) is entitled to 10% of the sub contracted price as a contract management fee. I am of the view that this charge of 10% is certainly a payment for the management and is encompassed within the provisions of section 8A (2b) of the Income Tax Act. Hence it is

the duty of the respondent to identify this amount and tax the appellant according to law. Similarly, the component of "training" too involves acquisition of know-how and a corresponding payment as seen in page 00089. The training component could therefore be separately assessed and levied the tax according to law, as it involves acquisition of know-how and a corresponding payment.

[23] Hence on consideration of all the facts and for the above reasons I do not agree with the findings of the learned HCJ as he has erred in regard to his findings, and I set aside the judgment dated 16 July 2010 and grant the reliefs as prayed for in the originating summons filed on 11 July 2008 subject to the payment of NRMW Tax under management or supervision and training as stated above.

[24] Application allowed.

[25] Judgment of the learned High Court Judge dated 16th July 2010 is hereby set aside.

The reliefs 1, 2, 3 claimed by the plaintiff are allowed. Subject to the payment of management and training fees.

Parties to bear their own costs.

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HON.MR. JUSTICE S. CHANDRA
JUSTICE OF APPEAL

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HON. MR. JUSTICE S. LECAMWASAM
JUSTICE OF APPEAL

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HON.MR. JUSTICE S. BALAPATABENDI
JUSTICE OF APPEAL