

CASE BRIEF

FAN MILK GHANA LIMITED v. THE COMMISSIONER GENERAL, GHANA REVENUE AUTHORITY

Court: Court of Appeal, Civil Division, Accra

Suit No: H1/247/2020

Date of Judgment: 7th April, 2022

Judges: Henry A. Kwofie JA (Presiding), George K. Koomson JA, Richard Adjei-Frimpong JA

Judgment Delivered By: Koomson JA

FLYNOTE

Revenue Law – Tax appeals – Withholding tax – Distinction between discounts and commissions – Whether payments to distributors at end of month based on sales volume constitute discounts or commissions – Re-characterization of payments under general anti-avoidance rule – Section 34 of Income Tax Act, 2015 (Act 896) – Sections 116(1)(a)(v) and 117(3) of Act 896 – Section 92 of Revenue Administration Act, 2016 (Act 915) – Held: Payments were commissions disguised as discounts; appellant failed to discharge burden of proof; arrangement was sham to avoid withholding tax; High Court decision affirmed.

Taxation – Accounting principles – Cash discount versus commission – Proper recording of discounts in accounting books required – Frank Wood's Business Accounting principles – Absence of proper accounting entries fatal to claim of genuine discounts – Evidence of compliance with accounting standards essential.

Agency Law – Indirect agency – Use of term "Agents" in formal agreement – Presumption that word used in proper legal connotation – Shell Company of Australia principle – Fixed pricing by principal indicates agency relationship – Commission agent arrangement.

Burden of Proof – Section 92(1) of Act 915 – Taxpayer bears burden to show compliance with tax law – Failure to produce accounting records showing discount treatment – Burden not discharged – Appeal dismissed.

FACTS

Background is identical to High Court case (see HC brief for full details).

Additional Appeal Context:

1. High Court affirmed Respondent's tax decision on 29th April 2019, dismissing appeal in its entirety.
2. Appellant appealed to Court of Appeal challenging High Court's findings on six grounds.

3. Key evidence: **Exhibit FM3** - document titled "TRADE TERMS CONTRACT FOR AGENTS" with sub-heading "CASH DISCOUNT RATES EFFECTIVE FEBRUARY 2015"
 4. Exhibit FM3 provided table showing:
 - Volume of sales required
 - Corresponding "discount" rate payable
 - Example: Net sale of GH¢50,000+ at month-end = 9.5% "cash discount"
 5. Appellant's described model: Distributors purchase products with instant/8-day payment; at month-end, Appellant calculates total purchases and "pays back as discounts" portions of monies paid.
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ISSUES

Fundamental Issue:

Whether Respondent was justified in its tax decision against Appellant resulting from failure to withhold taxes on payments made by Appellant to its Independent Purchasers/Distributors from 2014 to 2016.

Embedded Issue:

Whether those payments were in substance "discounts" or "commissions."

ARGUMENTS

Appellant's Arguments

1. **Nature of Discounts:** Black's Law Dictionary defines discount as "reduction from full amount or value"
 - Validity of commission depends on agent/employee relationship
 - Validity of discount does not depend on such relationship
2. **Business Model:** System of "indicative discounts at end of every month" computed based on purchases
 - Not service fees paid to sales agents
 - So, not subject to withholding tax under Section 116(1)(a)(v) of Act 896
3. **Practice Note:** Respondent's Practice Note DT/2016/001 confirms discounts not subject to withholding tax
4. **Trial Judge Errors:** Six grounds alleging errors including:
 - Wrongly finding tax avoidance scheme without evidence

- Erroneously applying new law retrospectively
- Incorrectly requiring discounts appear on invoices
- Mischaracterizing payments as commissions
- Improperly upholding tax liability
- Decision against weight of evidence

Respondent's Arguments

1. Reiterated High Court findings on distinction between discounts and commissions
 2. High Court correctly affirmed decision to treat payments as commissions rather than discounts
 3. Proper exercise of re-characterization power under Section 34 of Act 896
 4. Appellant failed to discharge burden under Section 92(1) of Act 915
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HOLDING

APPEAL DISMISSED IN ITS ENTIRETY.

High Court judgment of 29th April 2019 **AFFIRMED** in all respects.

REASONING

1. Appellate Court's Role and Burden of Proof

Rehearing Principle:

Court of Appeal must review whole evidence and come to own conclusion on facts and law.

"The appellate court, so far as appeals are concerned, is virtually in the same position as if the rehearing were the original hearing and may review the whole case and not merely the points as to which the appeal was brought."

Burden of Proof - Section 92:

In tax recovery appeals, burden on taxpayer to show compliance with tax law. In penalty cases, burden on Commissioner-General.

2. Tax Avoidance Context

Lord Reid's Statement in *Greenberg v IRC*:

"We seem to have travelled a long way from the general and salutary rule that the subject is not to be taxed except by plain words. But I must recognize that plain words are seldom adequate to anticipate and forestall the multiplicity of ingenious schemes which are constantly being devised to evade taxation."

Parliament properly determined to prevent tax evasion through legislation like Section 34 of Act 896.

Sham Transactions:

Rights and liabilities created by sham transactions will always be disregarded by tax authorities and courts.

Johnson v Jewith [1961] 40 TC 231: Flagrant attempt to create artificial loss rejected as "fiscal conjuring and bookkeeping fantasy."

3. Definitions - Discount vs Commission

Discount (Ordinary Meaning for Sales):

"Reduction in the original price of the product either for prompt payment or bulk payment."

Black's Law Dictionary, 9th ed.: "A reduction from the full amount or value of something."

Implication: Once seller offers discount, **original price is reduced.**

Commission:

Black's Law Dictionary, 7th ed.: "A fee paid to an agent or employee for a particular transaction, usually as a percentage of the money received from the transaction."

For sales: Fee paid to salesperson for facilitating/completing sale, structured as flat fee or percentage of revenue/gross margin/profit.

In substance: Commissions are fees paid by person who enjoys service rendered for some service provided.

4. Types of Discounts - Accounting Treatment

Trade Discount:

- Reduction in list price
- Allowed by supplier to purchaser when selling in bulk quantities
- **Executed when buyer initiates buy order**
- **NOT RECORDED** - amount payable calculated after deducting discount from invoice itself

Cash Discount:

- Discount for cash payment to recover cash debts on time
- Motivates buyer to pay early
- **Executed when buyer initiates payment**
- **RECORDED at debit side on cash book**

Accounting Principle (per Frank Wood's Business Accounting):

Seller records cash discount with:

- **Debit to accounts - sales discounts**

- **Credit to purchaser's account**
- Results in **reduction to cost** of item in inventory

"Any simple audit of the accounts book of a trader who provides cash discount must clearly indicate an entry of cash discount given to a buyer."

5. Analysis of Appellant's Model - NOT Cash Discount

Critical Analysis of Exhibit FM3:

Document titled: "TRADE TERMS CONTRACT FOR **AGENTS**" Sub-heading: "CASH DISCOUNT RATES EFFECTIVE FEBRUARY 2015"

States: "Cash discounts shall be paid to all qualifying **Agents** based on the table..."

Table Structure:

- Links payment to volume of sales achieved
- Example: GH¢50,000+ net sales = 9.5% payment

Court's Finding:

"In the opinion of this Court, the model operated by Appellant cannot be regarded as cash discounts. A cursory revision of Exhibit FM 3 shows that what an agent receives as 'discount' is not based on an **incentive to pay for the products promptly** to Appellant as per the meaning of cash discount but rather it is an **incentive for the Distributor for being able to sell off volumes of products** of Appellant."

Key Factors:

1. **Timing:** Cash back made **only at end of month** to determine volume of sales
2. **Basis:** Payment not for prompt payment but for sales volume achieved
3. **Formula:** "The more a distributor sells products of Appellant the more money a distributor receives as an incentive."

Conclusion:

"This is without a doubt, in substance, a '**commission**'."

6. Failure to Make Proper Accounting Entries

Critical Evidentiary Gap:

"However, upon careful review of the entire record of appeal, we were unable to find any evidence clearly indicating that Appellant had made the necessary entries in its books regarding the cash discounts in accordance with the standard accounting practise summarised above."

Legal Consequence:

If payments were genuine cash discounts, Appellant was obliged to make relevant entries in accounting books - would be obvious upon audit.

Holding:

"We therefore hold that the payments by Appellant to its Distributors were in substance '**commissions**' but not '**discounts**'."

7. The "Agents" Designation - Legal Significance

Exhibit FM3 as Agreement with "Agents":

Document is agreement "that the Appellant executed with its **Agents** but not ordinary independent purchasers of the products of the Appellant per se."

Examination of Agreement:

Clearly reveals Appellant intended payments as **motivation for attainment of set targets**.

Legal Presumption - *Shell Company* Principle:

"Where the term 'agent' is used in a formal document, **it may be presumed that the word is used in its proper legal connotation**, unless there are strong indications to the contrary."

Court's Finding:

"In the instant case, the Appellant has not led sufficient evidence on record to convince us that, the word 'Agents' which is used in its EXH. FM3, is not to be used in its proper legal connotation."

8. Characteristics of Indirect Agency

Observations:

1. **Agents deal with outside world in own names**
2. **BUT their obligations are to the Appellant**
3. **Appellant fixes the price** at which products are sold

Legal Analysis:

"The arrangement specified under EXH. FM3 appears to be an '**indirect agency**' which is similar to the contract of '**commission**'."

Ultimate Finding:

"It is our view that, the arrangement specified in EXH. FM3 is a **sham, put in place by the Appellant, to avoid the withholding tax obligation imposed by the law**."

9. Affirmation of High Court's Findings

Court of Appeal affirmed High Court's findings at page 135:

"The Respondent has told the Court that the Tax Audit did not find any price adjustments in the books of the Appellant. The Appellant has also not demonstrated to this Court that the necessary adjustments were made in its books concerning the so-called discounts given to its distributors. If the monies so

paid were discounts, why were the necessary price adjustments not made as is always the case in commercial or business transactions? If the Appellant had given cash discounts, and had recorded the same in the usual way, there would not have been any basis for the Respondent to re-characterize them as commissions."

10. Withholding Tax Obligation

Section 116(1)(a)(v) of Act 896:

Tax laws permit person making commission payments to **withhold tax** on payments to sales agent.

Court's Finding:

Since payments were **"in fact and in substance 'commissions' (service fees enjoyed by Appellant's Distributors)"**, Appellant was by law required to withhold tax.

Burden Not Discharged:

"The Appellant thus did not discharge the burden on him under section 92(1) of Act 915 that, it complied with the law."

11. Liability Under Section 117(3)

For failing to withhold tax, Respondent imposed liability of **GHC7,655,676.22** under Section 117(3) of Act 896.

Proper Exercise of Powers:

"Respondent in accordance with Act 896 and Act 915 having power to re-classify the arrangement between Appellant and its Distributors did indeed treat the cash discounts as commissions."

Tax Decision Properly Communicated:

Respondent communicated tax decision on 25th August 2017, received by Appellant on 29th August 2017.

12. Final Determination

"Therefore, this Court finds that Respondent was justified in its tax decision to impose a withholding tax liability on Appellant for failing to pay withholding tax on payments which were actually commissions but not discounts to its distributors for the years 2014, 2015 and 2016."

RATIO DECIDENDI

1. **Substance Over Form - Discount vs Commission:** A payment described as a "discount" but which is calculated and paid at the end of a period based on volume of sales achieved, rather than as an incentive for prompt payment, is in substance a commission regardless of its labeling. The economic substance and purpose of the payment determines its character, not the label attached to it.

2. **Accounting Evidence Essential:** For a taxpayer to establish that payments constitute genuine discounts, proper accounting entries in accordance with standard accounting practice (such as Frank Wood's Business Accounting principles) are essential. Absence of such entries reflecting cash discount treatment in audited books is fatal to a claim that payments were discounts.
3. **"Agents" in Formal Documents - Presumption:** Where the term "agent" is used in a formal commercial agreement, it is presumed the word is used in its proper legal connotation unless strong evidence indicates otherwise. The burden is on the party seeking to depart from this presumption to provide such evidence.
4. **Characteristics of Commission Arrangement:**
 - Payment calculated as percentage of sales volume achieved
 - Payment made at end of period after determining sales
 - Principal fixes prices at which products sold by "distributors"
 - Payment serves as incentive/motivation for achieving targets
 - These characteristics indicate commission, not discount
5. **Sham Arrangements - Tax Avoidance:** An arrangement documented as providing "discounts" to "agents" where payments are based on sales volume, agents have no pricing discretion, and no proper accounting treatment is applied, constitutes a sham arrangement designed to avoid withholding tax obligations under Section 116(1)(a)(v) of Act 896.
6. **Burden of Proof - Section 92(1):** In tax recovery proceedings, the taxpayer bears the burden under Section 92(1) of Act 915 to demonstrate compliance with tax law provisions. Failure to produce accounting records, proper documentation of discount treatment, or evidence of price reductions means the burden is not discharged.
7. **Re-characterization Power - Section 34:** The Commissioner-General's power under Section 34 of Act 896 to re-characterize arrangements that constitute tax avoidance schemes extends to treating mislabeled commissions as what they truly are, regardless of the parties' chosen terminology.
8. **Indirect Agency Concept:** Where distributors deal with the outside world in their own names but have obligations to a manufacturer who controls pricing, this constitutes "indirect agency" similar to commission agent arrangements, making payments to such agents subject to withholding tax.
9. **Trade Discount vs Cash Discount - Accounting Treatment:** Trade discounts are executed when buyer initiates purchase order and are not recorded separately (reflected in invoice price). Cash discounts are executed when buyer makes payment and must be recorded at debit side of cash book with corresponding entries. Failure to follow proper treatment indicates payments are neither type of discount.

10. **Appellate Review - Tax Cases:** On appeal from tax decisions, appellate court must review whole evidence and reach own conclusions on facts and law. However, where lower court's findings are supported by evidence and proper application of accounting principles, appellate court will affirm.