

THE EASTERN CARIBBEAN SUPREME COURT
SAINT VINCENT AND THE GRENADINES
IN THE HIGH COURT OF JUSTICE

SVGHCV2021/0007A

IN THE MATTER OF THE INCOME TAX ACT CHAPTER 435 OF THE LAWS OF SAINT VINCENT AND
THE GRENADINES REVISED EDITION 2009

AND IN THE MATTER OF AN APPEAL FROM AN ORDER OF THE APPEAL COMMISSIONERS
DATED 18TH DECEMBER 2020

BETWEEN

MASSY STORES (SVG) LTD

CLAIMANT/APPELLANT

AND

APPEAL COMMISSIONERS
COMPTROLLER OF INLAND REVENUE

FIRST DEFENDANT/RESPONDENT
SECOND DEFENDANT/RESPONDENT

Appearances:

Mr. Claude Denbow, Ms. Paula David and Ms. Zoe Williams for Applicant/Claimant

Mr. Grahame Bollers for the First named Respondent

Mr. Duane Daniel and Ms. Jenell Gibson for the Second named Respondent

Ms. Vanessa DeSouza for the Applicant

Mr. Harold Lewis for the First named Respondent

Mr. Kelvin Pompey and Ms. Kizzy Francis for the Second named Respondent

2022: March 15th
June 2nd

JUDGMENT

BYER, J.:

- [1] The Claimant/Appellant is a company incorporated in St. Vincent and the Grenadines. Its operations primarily concern the sale of retail foods and general merchandise in St. Vincent and the Grenadines.

- [2] By letter dated 26 September 2017¹, the second defendant/respondent (hereinafter referred to as “the second defendant”) informed the claimant/appellant (hereinafter referred to as “the claimant”) that there were differences between the cost of sales reported in the financial statements and that which was reported in the trial balance. These differences were explained as being stock adjustment which were charged to cost of sales to reflect damaged goods, expired goods, spoilage and differences between the physical stock count and the journals (unknown shrink). The second defendant disallowed these excess amounts charged to cost of sales and adjustments were made to its tax liability resulting in liability for the sum of \$371,645.00 for the period 2012-2016.
- [3] The second defendant based this assessment on section 34 (2) of the Income Tax Act, CAP 435 of the Laws of St. Vincent and the Grenadines, Revised Edition 2009 (hereinafter referred to as “the ITA”) which permits the second defendant to assess the income of a business by reference to the value of any trading stock held at the beginning and end of the basis period in accordance with the First Schedule. The First Schedule provides that any trading stock which was disposed of for consideration which cannot be valued shall be deemed to have been disposed to at an amount equal to the amount which, in the opinion of the second defendant, was the current market price of the stock.
- [4] By letter dated 26 October 2017², the claimant gave notice of its objection to the second defendant’s assessment on the basis that there was no disposal of the contested stock for consideration which could not be valued. The claimant/appellant argued that shrinkage is an inherent risk of business within the supermarket retail industry and such costs represent an irrevocable cost to the claimant/appellant which were incurred in the production of income.
- [5] The second defendant requested an explanation of the differences in the cost of sales in the financial statement and the trial balance and an explanation of the methodology used to determine the value of the costs of sales by its letter to the claimant dated 4 December 2017³.
- [6] The claimant provided the explanation sought in its letter to the second defendant dated 15 January 2018⁴. The claimant/appellant indicated that the cost of goods sold was calculated as the difference between the stock available for sale during the financial period less goods that were used for internal production and closing stock at the end of the period. It expounded further that in the retail sector, cost of sales included elements such as product shrinkage and pilferage.
- [7] The second defendant responded by letter dated 15 November 2018⁵ confirming the claimant’s tax liability in the sum of \$371,645.41 and disallowing the claimant’s objection. The second defendant contended that an amount was already claimed and allowed to the claimant for known shrinkage. In addition to section 34 of the ITA, the second defendant also placed reliance on

¹ See Trial Bundle Vol 1 filed on 18 February 2022, pg44

² See Trial Bundle Vol 1 filed on 18 February 2022, pg47

³ See Trial Bundle Vol 1 filed on 18 February 2022, pg78

⁴ See Trial Bundle Vol 1 filed on 18 February 2022, pg80

⁵ See Trial Bundle Vol 1 filed on 18 February 2022, pg50

section 45(1)(a) of the ITA which provides that no deduction shall be granted in respect of expenditure which is not incurred by the business for the purpose of producing assessable income.

- [8] The claimant, by Notice of Appeal dated 19 December 2019 appealed the second defendant's assessment before the first defendant/respondent, the Income Tax Appeal Commissioners (hereinafter referred to as "the first defendant"). The claimant's argument, in essence, was that the sums claimed for unknown shrink ought to have been allowed as an element of cost of goods sold. It asserted that shrink (known or unknown) represented an actual cost of doing business. They maintained that the stock adjustment was not a disposal for consideration which cannot be valued. It contended that unknown shrink was a norm in the retail supermarket industry and although the specific cause of the loss is unknown, it represents real stock inventory loss.
- [9] The second defendant on the other hand contended that section 39(2) of the ITA required that any such claim for a deduction must be verified by such evidence as may be requested by the second defendant. The second defendant maintained that in the absence of specific evidence related to the loss claimed, these figures representing unknown shrink were disallowed in accordance with section 39(2) and 45(1) of the ITA. The second defendant withdrew its reliance on section 34(2) of the ITA.
- [10] The first defendant ultimately held in their decision of 18 December 2020⁶ that the second defendant could not be faulted for adhering to the letter of the law in making his assessment of the claimant's tax liability. The first defendant recommended that the respondent look into the issue of shrink and set parameters for the percentage which could be allowed for unknown shrink. In the interim, the first defendant ordered that 50% of the amounts claimed by the appellant be allowed as cost of sales for the relevant period and that the claimant's tax liability and interest charges be adjusted accordingly.
- [11] The claimant then filed the instant claim appealing the decision of the first defendant and seeks orders that the decision of the first defendant on the 18 December 2020 be set aside and reversed and that the assessment of the second defendant dated 15 November 2018 be set aside and that the claimant's liability for the income years 2014-2016 be reduced to zero⁷.
- [12] The second defendant contests the instant claim and seeks an order pursuant to section 106 of the ITA that the decision of the first defendant allowing 50% of the amounts claimed by the claimant/appellant be set aside and that the assessment of the second defendant as it relates to the claimant/appellant's tax liability ought to be confirmed.
- [13] The trial of this matter was conducted on 15 March 2022. The claimant relied on the evidence of three witnesses: Henry Bryant, Martin Dorville and Vanessa DeSouza. The second defendant relied on the evidence of Kelvin Pompey.

⁶ See Trial Bundle Vol 1 filed on 18 February 2022, pg22

⁷ See Trial Bundle Vol 1 filed on 18 February 2022, pg3

[14] The grounds of appeal were comprehensively set out in the Statement of Claim filed by the claimant on 20 January 2021. These state as follows:

“10. That the defendant erred and misdirected itself in law by failing to take into account the following evidence provided on behalf of the claimant and to acknowledge and recognize that the Comptroller of Inland Revenue (CIR) had also failed to do so in raising and upholding his assessment:

- (i) That unknown shrink is a natural phenomenon which is inherent in the conduct of the supermarket business worldwide. It is the loss of stock which has been purchased and paid for but has not been sold or is not in inventory.*
- (ii) That there are a number of reasons or factors which cause losses attributable to unknown shrink. Such factors include inter alia:*
 - a. undetected employee theft;*
 - b. undetected pilferage and shoplifting;*
 - c. undetected customer damages;*
 - d. product water loss in transit and during storage particularly in respect of perishable items;*
 - e. production losses for cooked food items prepared for sale within the supermarket;*
 - f. employee/cashier errors*
- (iii) That unknown shrink is a normal cost of doing business in the retail industry and in particular the supermarket industry by reason of the factors set out above. Accordingly, such unrecorded losses constitute a standard cost of doing business and a legitimate deductible expense in computing the assessable income of a taxpayer involved in the supermarket business.*
- (iv) That almost all of the factors which contribute to losses referred to as unknown shrink, emanate from the conduct of human beings in terms of negligence and lack of honesty when functioning in the supermarket business or services related to the supermarket business. Such human conduct exists in the countries of the Caribbean Community including Saint Vincent and the Grenadines (SVG) as well as in the countries of the outside world including the United States of America. All of those factors contributing to unknown shrink are to be regarded as present in the retail supermarket industry in SVG as they are in other countries.*
- (v) That unknown shrink is a loss which normally occurs but cannot be specifically identified and it is not possible for the taxpayer, such as the claimant, to provide specific evidence as to which factors referred to above, have contributed to the losses in any particular year. However, it is undeniable that the operations of the foregoing factors do contribute to the Cost of Sales.*

11. That the defendant erred and misdirected itself in law by failing to find that the only reasonable way in which the losses arising from unknown shrink can be properly utilized and recognized in accordance with tax law is for a percentage of the Cost of Goods Sold attributable to unknown shrink, to be treated as deductible expenditure incurred in the production of assessable income of a taxpayer such as the claimant.

12. That the defendant erred and misdirected itself in law by failing to take into account that the most sophisticated supermarket surveys conducted of shrink estimate the ranges from 1.76% to 3.1% of sales in an average income year. Further, that in respect of the claimant the range was 1.5% to 2.4% for the years 2014 – 2016 which was reasonable, proportionate and within the normal range experienced by efficiently operated supermarkets in the developed world.

13. That the defendant erred and misdirected itself in law by failing to find that the refusal by the CIR to recognize the legitimacy of allowing the claim for unknown shrink as a deductible expense on the basis that there was no specific evidence of how the losses occurred was irrational and unsustainable as a matter of law. In that regard, the CIR provided neither explanations nor reasons as to why he rejected and failed to allow the claimant to deduct such losses save and except to state that he had an absolute discretion so to do in the absence of the specific evidence which he required.

14. That the defendant erred and misdirected itself in law by failing to find on the totality of the evidence presented as follows:

i. That cost of sales is a deductible expense in computing the assessable income of a taxpayer such as the claimant.

ii. That both known and unknown shrink constitute stock losses which are deductible in computing the income of a taxpayer involved in the supermarket business as part of the costs of sales.

iii. Unknown shrink is allowable as a deduction in computing assessable income of the taxpayer because to decline to do so would result in a failure to recognize the true reflection of income earned.

iv. Unknown shrink is deductible because it amounts to and creates involuntary outgoings and unavoidable losses which are recognized as a natural incident of a particular trade or business. Such stock losses are to be taken into account in arriving at assessable income so as to avoid inflating the value of hypothetical sales and imposing tax on a taxpayer where income has not been earned.

v. The below mentioned amounts charged to the Cost of Sales by the claimant in respect of unknown shrink ought not to have been disallowed by the CIR in computing the

assessable income of the claimant for the relevant income years pursuant to **section 39 of the Income Tax Act**.

Tax Period 2014: Cost of Sales	\$382,955.62
Tax Period 2015: Cost of Sales	\$917,902.49
Tax Period 2016: Cost of Sales	\$655,014.66

vi. The aforementioned amount ought to have been allowed as deductible expenditure incurred by the claimant in producing its assessable income for the years in question.

Construction of Section 39(2) of the Income Tax Act, CAP 435 (ITA)

15. That the defendant erred and misdirected itself in law by failing to find as follows:

- i. That the power vested in the CIR under **section 39(2) of the ITA**, to be provided with such evidence as he may require in order to justify items claimed as deductible expenditure, does not confer on him an unlimited or absolute discretion in that regard as claimed by the CIR.
- ii. That in exercise of his powers under **section 39(2) of the ITA**, the CIR must act reasonably and take into account the following factors:
 - a. That unknown shrink arises from human misconduct or negligence which is neither admitted nor readily identifiable but nonetheless occurs in the normal course of operation in the supermarket business.
 - b. That having regard to the special circumstances in which unknown shrink arises, it is not reasonable to insist that specific evidence should be provided on each aspect of the human conduct which contributed to the losses flowing from such behavior.
 - c. That to require such specific evidence amounts to a burdensome and oppressive exercise of the statutory discretion conferred upon the CIR pursuant to **section 39 (2) of the ITA** which is not sustainable as a matter of law.

Section 45 (1)(a) of the ITA

16. That the defendant erred and misdirected itself in law by failing to find as follows:

- i. That the losses arising in respect of unknown shrink constitute expenditure which is incurred for the purpose of producing assessable income. Accordingly, such expenditure is not barred from deductibility by reason of **section 45 (1) (a) of the ITA**.
- ii. That the CIR was wrong in law to disallow the deductibility of the aforementioned losses by relying on **section 45 (1) (a) of the ITA**.

Section 93 (3)(b) of the ITA: Best of judgment assessment

17. The defendant erred and misdirected itself in law by upholding the CIR's assessment dated 26 September 2017 which formed the subject matter of this appeal for the following reasons:

- i. That the best of judgment assessment is only sustainable if the CIR has formed a rational opinion in the circumstances of the case, has acted reasonably and has taken into account all the relevant circumstances.
- ii. That in this particular case, the CIR did not form a rational opinion as to the deductibility of losses claimed in respect of unknown shrink and failed to take into account that such an amount is one element in the Cost of Goods Sold which is a deductible item in computing the claimant's income for tax purposes.
- iii. That the claimant's shrink levels during the years in issue were not excessive and were within an acceptable range when compared to the more advanced and mature entities and countries globally.
- iv. That it was incumbent upon the CIR to articulate and provide explanations as to the matters which he took into account in forming a rational opinion that the losses incurred in respect of unknown shrink did not constitute a deductible item in computing the assessable income of the claimant. In having failed so to do, the CIR's disallowance of the claimant's claim to deduct losses referable to unknown shrink was unsustainable as a matter of law.
- v. That it was not permissible as a matter of law for the CIR to seek to justify his allowance of the losses referable to unknown shrink on the ground that he had an unlimited and absolute discretion to require the production of specific evidence to establish what factors caused the unknown shrink.
- vi. That the CIR acted in an arbitrary and irrational manner by disallowing the claim for the losses incurred in respect of the item referred to as unknown shrink and insisting that he had an absolute discretion to require specific evidence in support of what human conduct had contributed to the unknown shrink in this case when such elements are inherently incapable of being proven by specific evidence.

Guidance from Decided Cases in the Common Law World

18. That the defendant erred and misdirected itself in law in its decision making when it stated that **"The authorities put forward by the Appellant are from countries where the environment is or may be different from that which exists in Saint Vincent and the Grenadines."**

19. That in making the aforesaid statement in its decision, the defendant failed to act judicially and to recognize as follows:

i. That Saint Vincent and the Grenadines is part of the common law world and that judicial decision making is guided by precedent and case law emanating from the common law world.

ii. That the authorities relied on by the claimant were highly persuasive authority and ought to have been followed unless there were good reasons to depart from same. No such reasons were given by the defendant.

Section 105 of the ITA

*20. That the defendant erred and misdirected itself in fact and in law when it stated in its decision “it is hereby recommended that the respondent looks into the issue of shrink and set parameters for the percentage of which could be allowed for unknown shrink”. Such a decision was beyond the powers of the defendant under **section 105 of the ITA** and is neither sustainable nor permissible as a matter of law.”*

[15] It was however only at the case management of the matter on 11 February 2021, upon the claimant indicating that they would seek to cross examine the second defendant as to the evidence that he had filed at the Appeal before the first defendant that it was clear that the second defendant was a party to these proceedings. It was therefore upon that indication that the court then ordered that the Comptroller of Inland Revenue was to be added as a party and so he became the second defendant.

[16] At the trial of the matter it was clear to the court that the first defendant had no active role to play in defending their decision and the nub of the matter was as between the second defendant and the claimant as it was the extent of the second defendant’s assessment on the tax liability of the claimant that constituted the heart of the appeal.

[17] It was also agreed between the parties that these proceedings would constitute a de novo hearing of the grounds of appeal against the second defendant’s assessment as such this court would be empowered to make its own findings of fact and law.

[18] The trial lasted one day and at the conclusion of the trial and upon this court assessing the evidence that was elicited at trial the court is of the opinion that the following issues require the determination of the court:

i). Whether the second defendant’s assessment should stand he having failed to accept the sums claimed by the claimant as unknown shrink as a portion of the sum attributed to the cost of sales

In considering this issue the court will also be concerned with the sub issues of:

a) Whether the second defendant erred in law in insisting that a deduction of unknown shrink, as part of the cost of sales, was only permissible if the claimant could provide evidence to the satisfaction of the second defendant.

b) Whether the second defendant's denial of the claimant's claim to deduct unknown shrink as part of the cost of goods sold is unsustainable as a matter of law after the second defendant accepted that the claimant is entitled to deduct known shrink as part of the cost of goods sold as shown in its inventory records.

c) Whether the second defendant erred in law in insisting that amounts attributed to unknown shrink are only allowable if the factors which caused the unknown shrink could be identified or verified by way of evidence provided by the claimant.

d) Whether the second defendant was empowered to maintain his assessment disallowing the deductibility of unknown shrink as part of the cost of sales incurred by the claimant by relying on his power to raise a best of judgment assessment under **section 93 (3) (b) of the ITA.**

ii) Whether the order of the first defendant ordering 50% of the amounts claimed by the claimant should be allowed should be set aside and the assessment of the second defendant confirmed.

[19] However before this court embarks on the essence of this claim before the court, in the submissions of the second defendant, the second defendant raised an objection to the introduction of what they categorized as a new matter by the claimant at trial.

[20] The second defendant submitted that at trial much was made of whether the second defendant had in fact requested of the claimant any evidence which could have satisfied him to allow the deduction of the sum claimed as unknown shrink. In asking these questions of the second defendant, the second defendant submitted that for the first time the claimant was introducing a new allegation seeking to impugn the actions of the second defendant for failing to ask for specific evidence to substantiate the claim for unknown shrink. In doing so, the second defendant submitted that this trajectory substantially changed the case that had been brought by the claimant on the appeal and in fairness to the second defendant should be totally disregarded.

[21] Indeed the second defendant further contended that the only question that had been raised on the statement of claim/ground of appeal was whether the second defendant had acted rationally in requiring evidence to be provided by the claimant in support of the claim of unknown shrink, not that having failed to specifically ask for the evidence was an act of unreasonableness on the part of the second defendant. The second defendant therefore contended that having failed to raise this in their pleadings the second defendant was unable to provide the necessary documentation that would have substantiated his position that there had in fact been no such failure.

[22] Indeed when this court peruses the statement of claim/grounds of appeal it accepts that the failure of the second defendant in this regard was not raised on the pleadings. However, this court accepts that the claimant was placed in this position by the evidence of the second defendant in response to the claim of the claimant. In this court's mind, the second defendant is the one who brought this very issue into play.

[23] When the matter was brought for hearing before the first defendant, the second defendant in the evidence filed before the first defendant in response to the appeal at paragraph 14 had this to say:

“14. In relation to Paragraphs 16 and 17, during the audit conducted, the respondent noted differences between the Cost of Sales figures stated in the Appellant’s financial statements versus those stated in the trial balance. When the auditors requested reasons for the disparity, the Appellant indicated that there were stock adjustments made due to known and unknown shrink and provided detailed listings of the items which were damaged/spoiled/expired all of which were classified as known shrink. Based on the information provided on unknown shrink, the Respondent was informed that unknown shrink was categorized as the difference between the physical stockcount and the journal entries. The Respondent therefore then concluded that this difference was as a result of goods that were sold for which no value could have been determined and accordingly applied Section 34(2) and Paragraph 3 of the First Schedule. The Appellant’s letter of objection confirmed that the adjustments were not a disposal for consideration, but based on amounts claimed as a result of unknown shrink factors which could not have been identified or verified by the Appellant. As a result additional information provided in the Appellant’s letter of 15th January 2018, the Respondent confirmed its decision to disallow the amounts claimed for unknown shrink on the basis of there being no such evidence provided to just the amounts.” (My emphasis added)

[24] This position was again repeated by the second defendant in the affidavit he filed in the present proceedings⁸ before the court:

“13. In relation to paragraphs 16 and 17 of the referenced Affidavit of Martin Dorville, during the audit conducted, the Second Defendant noted differences between the Cost of Sales figures stated in the claimant’s financial statements versus those stated in the trial balance. When the auditors requested reasons for the disparity, the claimant indicated that there were stock adjustments made due to known and unknown shrink and provided detailed listings of the items which were damaged/spoiled/expired all of which were classified as known shrink. Based on the information provided on unknown shrink, the Second Defendant was informed that unknown shrink was categorized as the difference between the physical stock and the journal entries. The Second Defendant was, therefore, being asked to deprive the Revenue of legitimate taxes based on differences between the physical stock and journal entries. These differences could have amounted from various sources such as incorrect data entry. The provisions of the Income Tax Act clearly outline that only specific expenditure can be allowed. This legislation does not permit the tax payer to pass unexplainable differences off as expenses without providing any independently verifiable evidence to support such a claim. For this reason, the sums claimed as unknown shrink were disallowed.” (My emphasis added)

[25] In this court’s mind it was therefore clearly the second defendant who had spoken about “verifiable evidence” or “no such evidence” being provided by the claimant to substantiate the claim for the

⁸ Filed 11/10/2021

item stated as unknown shrink. It was therefore clearly within the right of the claimant in cross examination to question the second defendant as to whether he had in fact notified the claimant as to the nature of the evidence that would have been verifiable or requisite evidence at all. Indeed the second defendant on cross examination, in his conviction that he had made the correct assessment reiterated to this court that “the company failed to produce the necessary evidence to support those expenses”. In this court’s mind, the second defendant having failed to identify at any point what evidence the claimant was to produce, the claimant was entitled to raise with the court whether this failure was part and parcel of the reasonable actions of the second defendant indisallowing this sum as an expense. Indeed this court does not accept that this was a “new claim” as posited by the second defendant there having been a clear indication in the joint issues contained in the Pre Trial Memorandum filed on 11 March 2022 that the question was being asked if the second defendant had erred in law to insist that amounts attributed to unknown shrink are only allowable if the factors attached to the same can be verified by way of evidence. For the court to determine this issue, it is clear that the manner in which the second defendant responded to the claim must be considered in its totality.

[26] I therefore soundly reject any attempt by the second defendant to suggest that the evidence elicited on cross examination on this issue should be disregarded.

Issue #1- Whether the second defendant’s assessment should stand he having failed to accept the sums claimed by the claimant as unknown shrink as a portion of the sum attributed to the cost of sales

[27] In determining this issue, it was clear to the court that the nub of this issue was whether the concept of unknown shrink could be considered a portion of what makes up the cost of sales and whether in particular the ITA⁹ of this State makes provision for this to be an allowable deduction for the purposes of the calculation of tax liability.

[28] In that regard there has to be a clear understanding as to what is unknown shrink.

[29] Indeed it was clear from the evidence of the second defendant himself that until this concept had been raised by the claimant in their audit, this was not a term with which he was familiar. In fact in cross examination, he admitted that when he first wrote to the claimant on 20 September 2017 in which he first raised the extent of the tax liability of the claimant, he had no idea about the concept of unknown shrink. On cross examination he stated the following:

1. *“I am not aware of the matters impacting unknown shrink*
2. *I have not addressed my mind to the causes of unknown shrink*
3. *I am not familiar with the supermarket business so cannot accept that these are causes in the industry, and*

⁹ CAP 435 of the Revised Laws of Saint Vincent and the Grenadines

4. *There are dozens of businesses operating in St Vincent and it would be difficult for me to take a note of all the intricacies of all their business practices and accounting.”*

[30] The concept of unknown shrink was therefore an unknown entity in and of itself.

Unknown Shrink

[31] It was clear to this court that the concept of unknown shrink was not one that was known with any degree of familiarity in the Commonwealth countries or the common law countries, however the concept of shrink is and was known.

[32] In the evidence¹⁰ of Henry Joe Bryant he clearly states the difference between known shrink (which was allowed) and unknown shrink (which was not):

“There are two types of shrink – known shrink commonly referred to as spoilage/damaged, and unknown shrink commonly referred to in the supermarket industry as shrink. Known shrink or spoilage/damages refers to any loss of goods that is properly recorded and accounted for with evidence and documentation to support that result. Supermarkets have spoilage logs in departments to record spoilages/damages which are then checked and verified to allow proper inventory adjustments. However, when the logs are not fully used or incorrectly inputted unknown shrink results. Employees discarding spoiled or damaged product and not correctly logging the items for example would lead to unknown shrink while if properly done, known shrink would occur.”

[33] Unknown shrink is therefore the difference between what the company computes that they are supposed to have on hand as opposed to what they in fact have on hand once inventory stock count is taken. The reason is that although a figure may be ascribed to it, the causes of that can vary and in most cases cannot in fact be determined.

[34] The learned authors of the tax text De Voil Indirect Tax Service put it this way¹¹:

“It is an unfortunate fact that stock losses occur even in the best-regulated businesses. This is euphemistically referred to as ‘shrinkage’ and can arise from a number of factors. For example, goods can be short delivered, become unsaleable due to damage or obsolescence, be stolen, or be consumed in the business in one way or another. Whatever the reason, however, it is necessary to estimate the cost of stock losses during the test period to avoid inflating the value of hypothetical sales.”

[35] However, the recognition of unknown shrink or estimated shrink which the claimant have sought to proffer has gained wider acceptance in the jurisdiction of the United States¹² where the courts held

¹⁰ Affidavit in the appeal matter sworn to 21/3/2019 page 53 TB 1 filed 18/2/2022

¹¹ Paragraph V5.252 Duties, Records and Control

that if these sums were not taken into consideration, even where the cause of the same is not known, the figures that are presented would not reflect a true indication of the business or the income generated in any one financial period.

[36] Therefore in assessing the tax liability of any tax payer, this court is satisfied that such assessment must properly reflect what in fact the tax payer is liable to pay and also in this court's mind, it cannot be based on an arbitrary or capricious use of power by the persons who are responsible for such onerous tasks.

[37] The starting point therefore as to the correctness of the assessment must therefore examine the basis given for that assessment.

The Second Defendant's Assessment

[38] The assessment of the second defendant began by letter dated 26 September 2017¹³ in which the second defendant made it clear that he did not accept the figure that was attributed to the cost of sales which had no fixed explanation and the excess sums claimed as part of the cost of sales was disallowed.

[39] The claimant having objected to the assessment raised the concern¹⁴ that the if the figure claimed as a portion of the cost of sales, which was verified by the inventory counts that were presented, was not allowed it would essentially skew the income that had been made by the claimant and therefore what was in fact taxable.

[40] Subsequent to these two letters what transpired is therefore of some importance.

[41] By return letter dated 4 December 2017¹⁵ the second defendant sought from the claimant the following:

"Thus in an effort to make a complete determination on the issue of the Cost of Sales for the Tax Periods in question, the Department is hereby requesting:

1. *an **explanation** of the differences in the Cost of Sales as per the financial statements and the trial balance for the Tax Periods 2012-2016; and*
2. *an **explanation** of the methodology used to determine the value of the Cost of Sales."*
(My emphasis added)

¹² **Dayton Hudson Corporation v Commissioner** [1993] 101 TC 462 and **Dayton Hudson Corporation and Subsidiaries v Commissioner of Internal Revenue** No 97-3 027

¹³ Page 44 TB1 filed 18/2/2022

¹⁴ Letter dated 26th October 2017 page 47 TB1 filed 18/2/2022

¹⁵ Page 78 TB1 filed 18/2/2022

- [42] In response¹⁶ the claimant provided what was requested – an explanation – not evidence of the “difference” that the second defendant had identified between the cost of sales on the Financial Statements and the Trial Balance and also provided the clear methodology used to determine the cost of sales which is crucial in this court’s mind so the same is reproduced here in its entirety:

“Methodology used to determine the value of Cost of Sales

Cost of goods sold is calculated as the difference between stock available for sale during the Financial Period (opening stock add purchases made during the period) less goods that are used for internal production and closing stock at the end of the period.

In the retail sector, cost of sales includes elements such as product shrinkage and pilferage. A typical example of product shrinkage is the loss in the weight of perishable items between the point of purchase and the point of sales.

With regard to Massy Stores (SVG) Ltd., this loss of product due to shrinkage is identified and accounted for on completion of an actual stock count.

Please note that we are available to provide any further clarification on the above or [sic] information period.”

- [43] It is to this letter of explanation that the second defendant then made his final determination by correspondence dated 15 November 2018¹⁷.

**“Re: Objection – Massy Store Ltd.,
Corporate Income Tax Audit – Tax Periods 2014 to 2016**

*Pursuant to **Section 102 of the Income Tax Act Cap. 435 of the Revised Laws of St. Vincent and the Grenadines 2009**, and further to the Department’s letter of acknowledgement, this correspondence serves to officially inform you of the Comptroller’s decision with respect to the objection raised by Massy Stores Ltd. (“the Company”) in its letter dated 26 October 2017 and subsequent letter dated 15 January 2018.*

The Comptroller’s decision follows a review of the contents of the objection letter and the letter of 15 January 2018, and a further review of the details of the audit conducted for the captioned tax periods. Following the review process, the Comptroller has concluded that –

¹⁶Page 80 TB 1 filed 18/2/2022

¹⁷ Page 116 TB1 filed 18/2/2022

1. The arguments put forward by the Company in relation to unknown shrinkage included as an element of Cost of Goods Sold, are baseless given that an amount was already claimed and allowed to the Company for known shrinkage.
2. The reason proffered by the Company that “this is done for Management Purposes only and allows for consistency with our parent company ... and industry best practice” contravenes **Section 45(1)(a) of the Income Tax Act**, which states that no deduction shall be granted in respect of any expenditure which is not incurred by the business for the purpose of producing assessable income.
3. In accordance with **Section 34 and the First Schedule of the Income Tax Act**, the Department has the authority to place a current value on stock that cannot be accounted for; and include it in the Company’s assessable income.
4. This line item therefore cannot be allowed as an expense by the Company for tax purposes. It therefore means that the amounts were reasonably assessed by the Department under the Income Tax Act.

The Comptroller therefore affirms the Department’s assessment.

*Based on the foregoing, the Comptroller has wholly disallowed the Company’s objection and is demanding the full payment of the outstanding tax liability of **Three Hundred and Seventy One Thousand Six Hundred and Forty Five Dollars and Forty One Cents (\$371,645.41)** be made to the Department, on or before **Friday 23 November 2018**. Please be advised that failure to make the full payment of the said outstanding amount to the Department by the requisite deadline, would thereafter result in immediate enforcement action being taken against the Company.*

*If you do not agree with this decision **Section 104 of the Income Tax Act** affords you the right to appeal to the Income Tax Appeal Commissioners within thirty (30) days of the date of service of this letter. However, you are reminded that in accordance with **Section 107 of the Income Tax Act**, the payment of any tax, interest and penalty is not suspended by virtue of an appeal.”*

[44] The basis of the second defendant’s assessment was therefore initially and upon which the claimant appealed to the first defendant, sections 45 (1) (a) and 34(2) and the First Schedule of the ITA.

[45] Before the first defendant however, the second defendant made it clear¹⁸ that it withdrew its reliance on section 34(2) and the First schedule of the ITA and raised for the first time at the appeal that the claimant had failed to provide specific evidence pursuant to section 39(2) of the ITA. It is also this provision that the second defendant relied on at the trial of this matter along with the provisions of section 45(1) (a) of the ITA.

¹⁸ Page 127 TB1 filed 18/2/2022

[46] This court will therefore consider both provisions within the context of the trial of this matter.

Section 39(2) ITA

[47] Section 39(2) states the following:

“(2) Subject to subsection (3), in ascertaining the assessable income of any person for any year of assessment from any source specified in section 33 there shall, upon due claim and subject to such evidence as the Comptroller may require, be allowed as a deduction, all expenditure wholly and exclusively and, in the case of employment income, necessarily incurred by that person during the basis period for that year of assessment for the purpose of producing his assessable income from that source.”

[48] It is clear from the evidence that was elicited at trial and almost the entirety of the submissions of the second respondent, that reliance on section 39(2) served as the basis upon which the second respondent now states that he did not allow the deduction as claimed by the claimant for unknown shrink.

[49] Indeed the evidence of the second defendant was that¹⁹:

“I did not ask Massy to provide specific documents but they were told to produce documents in relation to expenses claimed. After I got the objection, I would have had meetings with the tax payer and those indications were made to the taxpayer.

Evidence was requested in meetings with the taxpayers

We had meetings outside of the correspondence

We did indicate the need for evidence at several meetings”

[50] It was therefore clear to the court that the second respondent at the stage of the assessment and even after the receipt of notice of objection made no formal request in this court's mind to the claimant for the production of evidence that he required in order to carry out a comprehensive assessment and thereafter to make a determination.

[51] Indeed it is admitted and identified by the second defendant in submissions that the second defendant under sections 83 and 84²⁰ of the ITA was empowered to seek information from the tax

¹⁹ Elicited on cross examination at the trial of the matter

²⁰ Section 83 (1) (a) (b) states the following:

“Further returns; production of books, etc.

(1) For the purposes of the administration or the enforcement of this Act, including the obtaining of full information in respect of the income of any person who is or may be liable to tax, the Comptroller may, by notice in writing, require that person or any other person -

payer once notice is issued. However, they went onto argue, quite incongruously in this court's opinion that even though these provisions existed, to substantiate their claim, it was solely their responsibility to produce all the documents that they would wish to rely on to establish their claim for deductions.

- [52] Indeed there is no doubt, a fact accepted by this court that the "statutory burden of the whole case is on the taxpayer"²¹ however in the case at bar the court must note the following. Firstly, there has been no indication that the claimant in fact did not provide any evidence at all²², the issue that arose with the second defendant in this court's mind was that he could not accept that although the figures clearly proved a reconciliation on the cost of sales²³, and that further that he could not accept that the figure could be considered "unknown shrink". Secondly, having accepted the methodology and the evidence that was produced to substantiate the cost of sales and the loss suffered due to items that could be clearly identified, the second defendant had in fact been provided with evidence, if it was not sufficient or not of the kind that was required, the second defendant was empowered to seek further clarification or evidence. He did not. There is no

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- (a) *to furnish to the Comptroller, at such time as may be specified in such notice, such further return of income, statement of assets and liabilities or other information as may be required by him;*
 - (b) *to produce, at such time and place as may be specified in such notice, for examination by the Comptroller or for retention by him for such period as may be reasonable for their examination, any accounts, books of account, statement of assets and liabilities or other documents which the Comptroller may consider necessary for such purpose and, if any such information is not available in the English language, to produce at the expense of the person who is, or may be, liable to tax a translation in English prepared and certified by an approved translator;"*

Section 84 states the following:

"Examination of business records

- (1) *Whether or not any person has been assessed to tax, the Comptroller may carry out an examination of the income tax affairs of such person, but subject to the limit as to time specified in section 97.*
- (2) *For the purposes of subsection (1), the Comptroller, or any officer authorised by him, may at all reasonable times, and subject to prior notice, enter into any premises where any business is carried on or the records or books of account of such business are kept, and-*
 - (a) *examine such records or books of account and examine any documents which relate to income accruing from such business;*
 - (b) *inspect any trading stock of the business in respect of which allowances or deductions have been, or may be, claimed under the Act;*
 - (c) *require the owner of the business, or any employee or agent, to give him such reasonable assistance in connection with the examination and inspection as may be necessary and to answer orally or in writing any questions relating thereto.*
- (3) *Where, during the course of any examination or inspection, it appears to the Comptroller, or the officer, that there may not have been a correct disclosure of assessable income or allowable deductions, he may take possession of any books of account or other documents for further examination at the office of the Comptroller, and after such examination may retain or make copies of, or take extracts from, such books or documents for the purposes of any prosecution or the substantiation of any assessment."*

²¹**Board of Inland Revenue v Maraj** TT 1984 CA 6 at para 50 per Kelsick CJ

²² This is the converse of what transpired in the case of **Napoleon Alleyne v The Board of Inland Revenue** TT 17/1972 Tax Appeal Board

²³ An admission made during cross examination at trial of the matter

evidence that he in fact did so and I do not accept on a balance of probabilities that this was requested by word of mouth as suggested by the second defendant in his evidence before this court. Thirdly having not sought to clarify what he required after the claimant had produced some evidence, this court finds that the claimant had discharged its statutory duty to prosecute and prove their case. It therefore cannot now be open to the second defendant to rely on the provisions of section 39(2) to raise new matters to which the claimant would not have had an opportunity to respond or act upon.

- [53] This court therefore accepts that the claimant produced evidence to substantiate their claim for the deductions that were claimed. The methodology was not flawed, the information was clear and the figures reconciled to the empirical evidence. Having failed to then seek from the claimant specific information instead of explanations as to what was presented, in this court's mind the second defendant was not in a position to rely on section 39(2) as reason to disallow the claim and therefore the only relevant question must now be whether the concept of unknown shrink and the cost attached to that can be subsumed within the parameters of section 45(1) (a) as a legitimate expense which is deductible.

Section 45(1) (a) ITA

- [54] Section 45 1(a) states the following:
"1(a) any expenditure to the extent to which it is not incurred for the purpose of producing assessable income;"
- [55] It is therefore clear that in order for the claimant to succeed on the claim for the cost of unknown shrink they must clearly show that it was incurred for the "purpose of producing assessable income."
- [56] It has not been disputed, that income tax can only be charged on assessable income²⁴. This assessable income is computed from the value of the stock at the beginning of a relevant tax period and the value of the stock at the end of that period. It is over that period where there are changes in the value of the stock which contribute to the cost of goods sold which "... is considered to be an expense deductible from the sales figure in the profit and loss account ... some profit and loss accounts will show the calculation of cost of goods sold as opening stock plus net purchases less closing stock."²⁵

²⁴ Section 6 ITA

²⁵ Simon's Taxes B2.602

- [57] It has also not been disputed that it is imperative that the liability of the tax payer should not be unduly inflated and as such the cost of goods sold must be accurately calculated and take into consideration all relevant expenses and costs in the computation of the payment of tax²⁶.
- [58] Indeed the court in the **Miksa Marton**²⁷ case stated it this way “incorrect valuation of inventory can distort business income. If closing inventory is overvalued compared with opening inventory, profits will be overstated...”
- [59] It is further not disputed that the cost of sales is a deductible expense in computing the assessable income of a taxpayer²⁸ so the sole question must therefore be - is unknown shrink such an integral part of cost of sales to be deductible even where it can be quantified empirically yet still have no ascribed reason for the same.
- [60] The claimant’s answer is of course yes it can.
- [61] It is the contention of the claimant that unknown shrink is an allowable deduction as the cost of doing business. It serves to ensure a clear reflection of income of the taxpayer even though exact evidence of it may be unavailable. Failing to do so, in the contention of the claimant, would give an inaccurate reflection of the income of a business. Additionally, unknown shrink, is such a loss that is so closely connected or incidental to the carrying on of a business enterprise that it should be allowed as a deduction to arrive at a true picture of the profitability of a business.
- [62] The second defendant in contrast submitted that the nub of the argument is that section 45(1) (a) is a very narrow category in which the claimant must find itself. Therefore they argued the court must determine the nature of the expense. Indeed although it may be recognized as, a legitimate expense it may still not be an allowable deduction under the statute. For as, legitimate as it may be if the statutory provision does not allow for it, it is not for the court to try and force it into a nonexistent category but rather for the law makers to address their minds to any such lacuna. Therefore the second defendant submitted that this court should not be led astray to allow for the deductibility of this expense by following case law from other jurisdictions that do not have the same statutory provisions as St. Vincent and the Grenadines.
- [63] In making this submission the second defendant further contends that the very fact that there is an inability to explain unknown shrink, the court is unable to examine and determine the nature of the expense to determine whether it is in fact an expense incurred for the purpose of producing assessable income. That is, the court must be satisfied that there must be a direct link between the expense and the production of assessable income. Having not been able to show that unknown

²⁶**Miksa Marton and Dualflex Company Limited v The Minister of National Revenue** 88 DTC 1047 (at page 10 /36 of the case at Tab 1 of the Claimant’s Submissions filed 8/4/2022)

²⁷ Ibid (at page 11/36 of the extract)

²⁸ Admission by the second defendant on cross examination at trial of the matter

shrink as incidental as it may for the production of income, is an expense for the production of assessable income, the second defendant submitted that the same cannot be an allowable deduction under the ITA.

- [64] When the court therefore considers the relative positions of the two parties to this matter, the court must be reminded that "...in a taxing Act one has to look merely at what is clearly said. There is no room for intendment. There is no equity about a tax. There is no presumption as to tax. Nothing is to be read in, nothing is to be implied. One can only look fairly at the language used."²⁹
- [65] It is therefore important that what was said in the ITA is noted and determined. The ITA at section 45(1)(a) clearly stated that if the expenditure is not incurred for the purpose of producing assessable income, then that deduction is not allowable. This court therefore agrees with the second defendant that in order to make that determination the nature of the expenditure as claimed by the claimant must be assessed.
- [66] This court has already given the definition of unknown shrink³⁰. By its mere name, the reasons that would be ascribed to this phenomenon are rarely if ever precisely known. By the mere fact that the reason for the expenditure may not be known, it is of interest to the court how a determination can in fact be made as to whether the sums are exclusively incurred for the purpose of producing assessable income. The argument of the claimant is that because this figure ascribed to unknown shrink would create an accurate reflection of income as it was in fact a loss to the company, that it should by right be deducted. By not taking it into consideration there would be a severely inaccurate inflation of the assessable income of the claimant.
- [67] This court is entirely in agreement with the claimant on that argument. What is even more of a concern to the court is that the second defendant accepted that the cost of sales included the items that the claimant could clearly identify as being part and parcel of the cost of sales, for example spoilage and there was no argument that that known expense was not part of allowable expenditure. The only argument that the second defendant has proffered to disallow this expenditure which has no fixed reason is because it is unknown. That is it, in a nutshell.
- [68] Indeed the argument of the second defendant was attractive in its analysis of the wording of varying statutory provisions and it being quite clear that with the very narrow ambit of the ITA that the wider use of the words in the taxing law of the United Kingdom where the expenditure has to be for the purposes of the trade³¹ those cases are of limited assistance. Further indeed if the court was to take a minute look at the nature of the expenditure it may have in fact agreed with the

²⁹**Cape Brandy Syndicate v Inland Revenue Commissioners** [1921] K.B. 64 at 71 per Rowlett J

³⁰ Paragraphs 31-37 above

³¹**Morgan v Tate & Lyle** [1953] EWCA Civ. J0506-3

second defendant that strictly speaking the cost claimed may not have been one incurred for the purpose of generating income.

- [69] However this court is satisfied that that is not how this exercise is to be approached and rather accepts the words of Dixon J in the case of **W. Nevill & Co Ltd v Federal Commissioner of Taxation**³² considering similar phraseology as the ITA that:

“... it is not correct to look only to the purpose actuating the expenditure in the state of facts in which it was resolved upon. The whole course of the transaction must be regarded. ... The purpose appears to me to govern the entire course of the transaction. ... A wide view should be taken of the meaning of s. 25 (3). For it is intended to apply to an infinite variety of sources of income. When the expenditure avoided or reduced has been or would be incurred for the production of income, it appears to me that the substituted expenditure comes fairly within the description money exclusively laid out for the production of income.”

- [70] Indeed in that same case³³ in considering legislation of the federal nature where the deduction is only allowable where it is actually incurred in gaining or producing the assessable income, Latham CJ had this to say, “[T]he mere reduction of expenditure, though it decreases the expenditure side of an account, does not increase the receipts side of the same account. In my opinion the answer to this contention is to be found in a recognition of the fact that it is necessary, for income tax purposes, to look at a business as a whole set of operations directed towards producing income. No expenditure, strictly and narrowly considered, in itself actually gains or produces income. It is an outgoing, not an incoming. Its character can be determined only in relation to the object which the person making the expenditure has in view. If the actual object is the conduct of the business on a profitable basis with that due regard to economy which is essential in any well-conducted business, then the expenditure is an expenditure incurred in gaining or producing the assessable income. If it is not a capital expenditure it should be deducted in ascertaining the taxable income of the taxpayer.”

- [71] In this court’s mind this is an entirely sensible approach to this matter. This position is even more solidified when this court considers that the “known” part of this expenditure was in fact accepted, a fact that seemed to have escaped the second defendant entirely.

- [72] That being said and looking at the entirety of the transaction, this court must find that if assessable income is what is taxable then the entirety of a transaction must be determined. In this court’s mind, the taxable income of the claimant could not include losses suffered and it is in suffering those losses that it must be considered an expenditure that the tax payer, in this case the claimant, ultimately incurred to produce its assessable income. In the words of Latham CJ³⁴ there is no other reason for this loss or expenditure other than for conducting the claimant’s business for profit.

³² High Court Australia 3/3/1937 cited with approval in **The Rum Factory of Jamaica v The Assessment Committee** High Court of Jamaica 7/12/1960

³³ **W. Nevill & Co Ltd** *ibid*

³⁴ *Ibid*

[73] This court therefore finds that the assessment of the second defendant in this regard must be set aside and in so doing by implication the finding of the first defendant is also set aside.

[74] The relief sought by the claimant is therefore granted and the tax liability in this regard is reduced to zero.

It is hereby ordered as follows:

ORDER

1. The Appeal by way of the Fixed Date Claim Form filed on 20 January 2021 is allowed.
2. The decision of the first defendant on 18 December 2002 is set aside and reversed.
3. The assessment raised by the second defendant dated 26 September 2017 is set aside and vacated.
4. The liability for the claimant for income years 2014- 2016 is reduced to zero.
5. Costs to the claimant on an unvalued claim pursuant to Part 65.5 CPR 2000.

Nicola Byer

HIGH COURT JUDGE

By the Court

Registrar