IN THE COURT OF APPEAL OF THE DEMOCRATIC SOCIALIST REPUBLIC OF SRI LANKA

In the matter of an appeal by way of Stated Case on a question of law for the opinion of the Court of Appeal under and in terms of Section 11A of the Tax Appeals Commission Act, No. 23 of 2011 (as amended).

Flintec Transducers (Pvt) Ltd,
P.O.Box 24, KEPZ,
Phase I Spur Road 2,
Katunayake.

APPELLANT

CA No. CA/TAX/0003/2018
Tax Appeals Commission
No. TAC/VAT/014/2013

v.

Commissioner General of Inland Revenue,
14th Floor, Secretarial Branch
Department of Inland Revenue,
Sir Chittampalam A, Gardiner Mawatha,
Colombo 2.

RESPONDENT

BEFORE : Dr. Ruwan Fernando J. &
M. Sampath K. B. Wijeratne J.

COUNSEL : Riad Ameen with Varana Wijenayake & Zam Zam Ismail for the Appellant.

Chaya Sri Nammuni, SSC
for the Respondent.

WRITTEN SUBMISSIONS	:	16.10.2018 & (by the Appellant)
		16.10.2018 & (by the Respondent)
ARGUED ON	:	11.01.2022
DECIDED ON	:	31.03.2022

M. Sampath K. B. Wijeratne J.

Introduction

The Appellant company (hereinafter referred to as 'the Appellant'), Flintec Transducers (Pvt) Ltd, is a company incorporated in Sri Lanka, engaged in the business of manufacturing and selling load cells for electronic scales.

The Appellant submitted its Value Added Tax (hereinafter referred to as 'VAT') returns for the taxable period from January 2007 (07031) to December 2008 (08123), and the Assessor rejected the said returns on the ground that the Appellant had not declared the value of;

i. material transferred to a related company worth Rs. 19,755,830,
ii. an insurance claim of Rs. 1,614,500 received on a vehicle, and
iii. a reimbursement of Rs. 31,491,313 by an affiliated company named Straintec (Pvt) Ltd.

Thereafter the Assessor, acting under Section 29 of the Value Added Tax Act No. 14 of 2002, as amended (hereinafter referred to as 'the VAT Act'), proceeded to issue a letter dated 25th May 2011, communicating the reasons as to why he did not accept the Appellant's return.[1]

The Appellant preferred an appeal to the Commissioner General of Inland Revenue (hereinafter referred to as 'the CGIR') on the 8th September 2011 in terms of Section 34 of the VAT Act, against the assessments issued in respect of the insurance claim of Rs. 1,614,500 received on a vehicle, and the sum of Rs. 31,491,313 reimbursed by the affiliated company.[2] According to the Petition of Appeal, the date of the Notice of Assessment is 9th August 2011. In the instant case it is important to note that the

[1] At page 15 of the appeal brief
[2] Petition of Appeal at page 17 of the appeal brief

authorised representative for the Appellant has acknowledged that the assessment under appeal has been made in the aforementioned Assessor's letter dated 25th May 2011.[3]

The Respondent, the CGIR, in his determination dated 16th September 2013 confirmed the assessment made by the Assessor.[4]

On being dissatisfied with the determination of the CGIR, the Appellant appealed to the Tax Appeals Commission (hereinafter referred to as 'TAC') in terms of Section 7 of the Tax Appeals Commission Act No. 23 of 2011, as amended (*vide* page 55 of the appeal brief). The TAC by its determination dated 21st September 2017, affirmed the determination of the CGIR and confirmed the assessment determined by the CGIR, thus dismissing the appeal.

The Appellant then moved the TAC to state a case on the following questions of law for the opinion of this Court, in terms of Section 11A of the TAC Act:

1. *Did the Commission err in law in holding that a sum of Rs.31,491,313 received by the appellant from its sister company Straintec (Pvt) Ltd is the consideration received for a taxable supply made by the appellant in circumstances in which the said sum of money was paid to the appellant in the settlement of the money paid by the appellant on behalf of Straintec (Pvt) Ltd in respect of the expenses incurred by Straintec (Pvt) Ltd?*
2. *Did the Commission err in law in acting on the decision in the Value Added Tax Tribunal (UK) case no. 103, Heart of variety vs Commissioners (1975) when the facts in the case were different from the facts in the case of the appellant?*
3. *Having regard to the charging section and definition of taxable activity given in Section 83 of the Value Added Tax Act No. 14 of 2002, did the Commission err in law in holding that a sum of Rs.1,614,500 which the appellant received under a policy of insurance in respect of a damaged motor vehicle represents a taxable supply liable to value Added tax?*

[3] Written submissions filed on behalf of the Appellant dated 25th August 2013, at page 39 of the appeal brief

[4] At page 41 of the appeal brief

4. *Did the Commission err in law in acting in relation to the issue referred to in the preceding question of law, on the decision in the case of H. R. Mattia Ltd (1976 VATTR 33), a case decided by the Value Added Tax Tribunal in the UK under the provisions of VAT legislation in that country in which the charging section and the definition of taxable activity is quite different from the charging section and the definition of taxable activity given in the Value Added Tax Act No. 14 of 2002 in Sri Lanka?*
5. *Did the Commission fail to properly examine and or apply and or appreciate the facts and law relevant to this matter?*

I will now consider the above questions of law, beginning with the first and second questions together.

1. ***Did the Commission err in law in holding that a sum of Rs.31,491,313 received by the appellant from its sister company Straintec (Pvt) Ltd is the consideration received for a taxable supply made by the appellant in circumstances in which the said sum of money was paid to the appellant in the settlement of the money paid by the appellant on behalf of Straintec (Pvt) Ltd in respect of the expenses incurred by Straintec (Pvt) Ltd?***

2. ***Did the commission err in law in acting on the decision in the Value Added Tax Tribunal (UK) case no. 103, Heart of variety vs Commissioners (1975) when the facts in the case were different from the facts in the case of the appellant?***

Section 2 (1) (a), the charging Section of the VAT Act, reads thus:

> *"2. (1) Subject to the provisions of this Act, a tax, to be known as the Value Added Tax (hereinafter referred to as "the tax") shall be charged-*
>
> > *(a) at the time of supply, on every **taxable supply** of goods or services, made in a taxable period, by a registered person **in the course of the carrying on, or carrying out**, of a **taxable activity** by such person in Sri Lanka,*

(b)… (emphasis added)

Accordingly, VAT could be imposed on a registered person;

i. in the course of;

ii. the carrying on, or carrying out of;

iii. a taxable activity

Arguments

The learned Counsel for the Appellant submitted that VAT is not charged on every supply made by a registered person. It has to be a *taxable supply*. It was also submitted that every taxable supply is not subject to VAT. For a taxable supply to be subject to VAT, the supply has to be made *'in the course of the carrying on, or carrying out, of a taxable activity'*.

The learned Counsel contrasted Section 2 (2) of the Finance Act 1972 of the United Kingdom and Section 8 of the GST Act in New Zeeland, with Section 2 (1) (a) of the Sri Lankan Act. The learned Counsel submitted that, initially, in the relevant provision of the VAT Act in the United Kingdom, the phrase used was '*in the course of a business* ***carried on*** *by him*' which is very much similar to the language used in our VAT Act, and subsequently, the Legislature in the United Kingdom introduced the word '***furtherance***' to enlarge the scope of VAT liability so that it then read '*in the course* ***or furtherance*** *of any business carried on by him*'. It was submitted that the GST Act in the New Zealand also contain the words '***in the course or furtherance of*** *a taxable activity* ***carried on***'. The learned Counsel submitted that the VAT Act in the Sri Lanka was enacted having regard to the corresponding laws applicable in the United Kingdom VAT Act and the New Zeeland GST Act. Accordingly, the learned Counsel strenuously argued that since the Legislature has deliberately avoided using the words '*furtherance of*' in the Sri Lankan VAT Act, fringe activities have not been made subject to VAT.

Thereafter, the learned Counsel proceeded to argue that the Appellant's main business is the manufacture and sale of load cells and therefore, the only *taxable supply* made by the Appellant '*in the course of the carrying on, or carrying out, of a taxable activity*' is the supply and sale of load cells.

On the above premise the leaned Counsel for the Appellant argued, assuming, without conceding, that even if the Appellant had supplied employees to Straintec (Pvt) Ltd (hereinafter referred to as 'Straintec'), such supply would not have been done '*in the course of the carrying on, or carrying out, of a taxable activity'* and therefore, there would be no VAT liability.

Nevertheless, the contention of the learned Counsel for the Appellant was that there was no evidence whatsoever that the Appellant supplied employees to its sister company, Straintec.

Analysis

Be that as it may, adverting to the first argument advanced by the learned Counsel, I observe that the words '*carried on'* in the United Kingdom and New Zeeland Acts connote the same meaning *carrying on* in our Act. Even though the words *furtherance of* are not in the charging section of the Sri Lankan law, the words '*carrying out*', which are not in the United Kingdom and New Zealand Acts, have been included. Therefore, any taxable supply of goods or services made ***in the course of the carrying out*** of a taxable activity is also captured under the Sri Lankan law, in addition to taxable supplies made in the course of the '*carrying on'* of a taxable activity. However, the words '*carrying on*' and '*carrying out*' are not defined in the Act. Therefore, those words have to be given their ordinary grammatical meaning.

At this point, it is apt to scrutinise the Sinhala text of Section 2 (1) (a) of the VAT Act. In terms of Article 23 (1) of the Constitution, all laws in Sri Lanka are enacted and published in the Sinhala and Tamil languages, together with an English translation. If there is an inconsistency between the Sinhala and Tamil texts, the Sinhala text shall prevail. Therefore, I deem it necessary to examine the Sinhala text of the aforementioned words '*in the course of the carrying on, or carrying out*'. The Sinhala text reads 'කරගෙන යාමේදී' (in the course of the carrying on) and 'කිරීමේදී' (in the course of carrying out). In my view the Sinhala phrase 'කරගෙන යාමේදී' connotes continuously performed acts with a certain frequency, whereas the word 'කිරීමේදී' connotes either an isolated act or a series of acts performed sporadically. Upon a careful consideration of the above words, it therefore appears that even a single taxable activity as well as fringe

activities are captured under the word 'කිරීමේදී' ('in the course of carrying out').

Through the above analysis, I find that there are significant differences between the charging section of the Sri Lankan VAT Act, and those of the United Kingdom VAT Act and the New Zealand GST Act.

Hence, I am of the view that the words *'in the course of the carrying on'* found in the English translation of Section 2 (1) (a) of the VAT Act should mean transactions continued over an appreciable period of time with a certain frequency; and the words *'in the course of the carrying out'* should mean a single taxable activity or a series of acts performed sporadically, whichever is the case based on the facts.

The second submission made by the learned Counsel for the Appellant is that the transactions in dispute are not VAT liable as they were not done '*in the course of the carrying on or carrying out of a* ***taxable activity***'.

The third submission made by the learned Counsel for the Appellant was that the transactions are not carried on as a business or a trade or an adventure or concern in the nature of a trade. The learned Counsel submitted that the Appellant is not in the business of supplying contract labour. I will consider both these submissions simultaneously since these two are interconnected.

The words *'business* and *'trade',* which are relevant to the instant case, are not interpreted in the VAT Act itself. Therefore, those words have to be given their natural and grammatical meaning.

The words '*taxable activity'* is defined in Section 83 of the VAT Act which reads as follows:

> *"'taxable activity' means*
>
> ***a.*** *any* ***activity carried on as a business****,* ***trade****, profession or occasion other than in the course of employment* ***or every adventure or concern in the nature of a trade;*** ……" (emphasis added)

The learned Counsel quoted the following observations made by Lord Morris in the case of *Grainger and son v. Gough*,[5] and argued that the

[5] 3 TC 462 at page 472

phrases 'exercising a trade' and 'carrying on a business' are synonyms and the business or trade must be habituated or systematically exercised and it cannot apply to an isolated transaction:

> *"There can be no definition of* ***the words 'exercising a trade'. It is only another mode of expressing 'carrying on a business****', but it certainly carries with it the meaning that the business or trade must be habitually or systematically exercised and* ***that it cannot apply to isolated transaction****".*

However, as is evident in this case, the reimbursement of payments made to the employees was not an isolated act, but an ongoing act done by the Appellant. The Appellant's authorised representative himself admitted this fact in the appeal preferred to the TAC.[6] The account statements of the Appellant company also establish this fact.[7]

The Appellant's contention is that it has been paying the salaries to both the employees of the Appellant and its sister company Straintec for administrative convenience. The Appellant has received the same amount from Straintec as reimbursement for expenses incurred on behalf of Straintec.[8] The Respondent has not rejected this proposition. This has been acknowledged by the Assessor in his letter of intimation,[9] and by the CGIR's representative at the interview.[10] However, the Respondent's contention was that reimbursement of salaries paid by the Appellant constitutes a consideration received for a taxable supply.[11] The Appellant, quite contrary to the submissions made before this Court, has conceded that the reimbursement of expenses is a taxable supply.[12] However, it has contended that the said supply is not made in the course of carrying on or carrying out of a *taxable activity*. In the written submissions made to this Court, the Appellant contended that although a reimbursement of expenses is liable for VAT where there is a supply of services, reimbursement without a supply is not VAT liable.[13]

[6] At page 184 of the appeal brief
[7] At pages 7-12 of the appeal brief
[8] At pages 17, 128, 133 and 184 of the appeal brief
[9] At page 15 of the appeal brief
[10] At page 24 of the appeal brief
[11] At pages 29 and 43 of the appeal brief
[12] At pages 17, 38 and 126 of the appeal brief
[13] At paragraph 81 of the Appellant's written submissions

The TAC, in its determination, relied on the case of *Heart of Variety v. Commissioners* (hereinafter referred to as *Heart of Variety*),[14] and held that the fact that a company receives nothing more than the reimbursement of sums paid out by the company, did not prevent the amounts paid or reimbursement received from being consideration for the supply of the services in question. Upon a careful scrutinization of the case of *Heart of Variety*, I observe that there are material differences in the facts of the two cases. In the case of *Heart of Variety*, the appellant was a charitable organization which ran a scheme for showing cinema films in children's homes. The driver-projectionists who operated the scheme, although they worked exclusively for and under the direction of the appellant in that case, were for administrative reasons nominally kept on the pay-roll of the commercial company of film exhibitors, EMI Cinemas and Leisure Ltd (EMI). The conditions of service of the driver-projectionists were fixed by the appellant but, the salaries, expenses, national insurance contributions, PAYE tax etc. were all paid and dealt with by EMI, to be reimbursed monthly by the appellant in that case. The amounts reimbursed were only the payments actually made and nothing more. Even in the case in hand, the amount reimbursed was the exact amount paid by the Appellant. In *Heart of Variety*, it was held that receiving nothing more than reimbursement of sums paid out does not prevent the amounts paid by way of reimbursement from being a consideration for a supply of the services in question.

However, in *Heart of Variety*, although the workers had exclusively worked for and under the direction of the appellant company, they remained employees of EMI in their pay-roll under a contract of employment. Therefore, the Court concluded that it is the EMI who supplied the services of the projectionists for a consideration (at page 7 of the judgment). However, in the instant case, it is an undisputed fact that the employees whose salaries were reimbursed by the Appellant are employees of Straintec. The Appellant's explanation for the payment of salaries and later receiving a reimbursement from Straintec was that both are related companies located in the same premises, and that this was done for administrative convenience. In the account statement of the Appellant filed

[14] [1975] VATTR 103

of record (at page 6 of the appeal brief) Straintec is named as a subsidiary of the Appellant.

At this stage, I must admit that a doubt arises in my mind as to why the salaries of the employees of Straintec were paid by the Appellant. More specifically, why were *only* the salaries paid. Being two different entities, Straintec would have had its own administrative mechanism. In fact, the Assessor, exercising his powers under Section 21 (4) of the VAT Act could easily have called for the letters of appointment of the employees etc., and cleared any doubt as to whether the Appellant had, in effect, supplied their employees to Straintec and got a reimbursement for the services supplied by the Appellant to Straintec. However, the Assessor has failed to exercise such powers with due diligence. Therefore, at this stage of the case, the only reasonable inference that this Court could draw on the available material is to accept the version of the Appellant that they had paid the salaries of the employees of Straintec for administrative convenience and later received a reimbursement.

In the circumstances, quite contrary to the case of *Heart of Variety*, in the case in hand, the employees of Straintec have supplied their services not to the Appellant, but to their own employer Straintec. Therefore, the dicta in Heart of Variety have no persuasive value in deciding the case in hand and holding that the Appellant has supplied a service for a consideration, and been later reimbursed by Straintec.

On the above analysis, I am of the view that the TAC has erred in law in relying on the decision in the case of *Heart of Variety* and holding that the sum of Rs. 31,491,313 received by the Appellant is consideration for a taxable supply of services made to Straintec by the Appellant.

I therefore answer the first and second questions of law in the affirmative. I will now consider the third and fourth questions of law together.

3. ***Having regard to the charging section and definition of taxable activity given in Section 83 of the Value Added Tax Act No. 14 of 2002, did the Commission err in law in holding that a sum of Rs. 1,614,500 which the appellant received under a policy of insurance in respect of a damaged motor vehicle represents a taxable supply liable to Value Added Tax?***

4. ***Did the Commission err in law in acting in relation to the issue referred to in the preceding question of law, on the decision in the case of H. R. Mattia Ltd (1976 VATTR 33), a case decided by the Value Added Tax Tribunal in the UK under the provisions of VAT legislation in that county in which the charging section and the definition of taxable activity is quite different from the charging section and the definition of taxable activity given in the Value Added Tax Act No. 14 of 2002 in Sri Lanka?***

The next matter in issue is an insurance indemnity received by the Appellant in respect of a damaged vehicle which was discarded. The Assessor treated the said amount as proceeds from disposal of property and the Appellant was assessed accordingly.

The contention of the Appellant is that the insurance claim received is not made *'in the course of carrying on or carrying out a taxable activity'*, and therefore, not liable for VAT. The Appellant argued that the said amount is received from a disposal of a capital asset and therefore, cannot be treated as an activity carried on as a business, trade or any adventure or concern in the nature of a trade.

In response, the Respondent argued that in the words of the VAT Act, sale of assets done in a business carried on by a registered person constitutes a taxable supply, and that this applies to all the assets and is not restricted to stock in trade.

The Appellant relied on the case of *Green v. Glikston & Sons Ltd*,[15] and argued that the amount received as insurance indemnity for damaged capital goods, has to be treated as a disposal of capital assets (para 67 of the Appellant's written submissions).

However, in the case of *H. B. Mattia Ltd*,[16] a wholesale dealer of television sets and radios sold several delivery vans which were used for the purpose of his business. The United Kingdom VAT Tribunal held that the sale of delivery vans, which formed part of assets of the business and which were used for the purpose of the business, can be said, when disposed by way of sale, to have been supplied in the course of the business carried on by the company. It is true that the case of *H. B. Mattia Ltd* involved the disposal

[15] 14 TC 364

[16] [1976] BVC 1047

of assets whereas the case in hand involves an insurance indemnity for a damaged capital asset, but by the Appellant's own submission above, these two are to be treated as equivalent. There is no information in the appeal brief for this Court to conclude that the vehicle for which the insurance indemnity was paid, was used for any purpose other than the purposes of the business itself. Furthermore, the learned Counsel for the Appellant did not explain in argument what exactly the vehicle was used for. For these reasons, and relying on the equivalence of facts that the Appellant has advocated for, I see no need to distinguish between *H. B. Mattia Ltd* and the case in hand.

The Appellant has raised the fourth question of law on the ground that the TAC had erred in law in relying on the decision of *H. B. Mattia Ltd*, a case based on the Finance Act 1972 of the United Kingdom, where the words '*furtherance of"* are used which are not in the VAT Act in Sri Lanka. I have already dealt with the differences of these words above in this judgment and held otherwise. Moreover, it appears to me that the words considered in the said judgment were not the aforesaid words but the words *'supply in the course of a business carried on'* which words are almost identical to the words *'in the course of the carrying on, ……a taxable activity'* used in the Sri Lankan VAT Act.

Therefore, I am of the view that the TAC did not err in following the decision of *H. B. Mattia Ltd*, since it has a persuasive value, though not binding in our jurisdiction.

Above all, I need not labour much on this matter since our statutory provisions are clear on this issue. The words '*supply of services*' as per Section 83 of the VAT Act stand for *'any supply which is not supply of goods but includes* ***any loss incurred in a taxable activity for which an indemnity is due'*** (emphasis added). Furthermore, a '*taxable activity*' is defined as:

(a) any activity carried on as a business, trade, profession or vocation other than in the course of employment or ***every adventure or concern in the nature of a trade****;*

(b) ... (emphasis added).

Therefore, it appears that the disposal of capital assets used for the purpose of the business falls within the definition of *'taxable activity'*, and therefore

the insurance indemnity received by the Appellant also falls within this definition, as the Appellant has submitted that said insurance indemnity is to be considered equivalent to the disposal of a capital asset.

Having reasoned as above, I answer the third and fourth questions of law in the negative.

the fifth questions of law is answered in the affirmative since the first and second questions of law are answered in the affirmative.

Conclusion

Accordingly, I answer the five questions of law in the case stated as follows;

1. **Yes**
2. **Yes**
3. **No**
4. **No**
5. **Yes**

In light of answers given to the above questions of law, acting under Section 11 A (6) of the TAC Act, I remit the case to the TAC with the opinion of Court that the assessment be revised accordingly.

The Registrar is directed to send a copy of this judgment to the Secretary of the TAC.

JUDGE OF THE COURT OF APPEAL

Dr. Ruwan Fernando J.

I Agree.

JUDGE OF THE COURT OF APPEAL