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).

Sri Lanka Insurance Corporation Limited,
No. 21, Vauxhall Street,
Colombo 02.

APPELLANT

Case No. CA/TAX/0019/2019
Tax Appeals Commission No. TAC/VAT/018/2016

Vs.

The Commissioner General of Inland Revenue,
Department of Inland Revenue,
Sir Chittampalam A. Gardiner Mawatha,
Colombo 02.

RESPONDENT

BEFORE	**:**	Dr. Ruwan Fernando J. &
		M. Sampath K.B. Wijeratne J.
COUNSEL	:	Nihal Fernando, PC. With Dr. Shivaji Felix and Harshula Seneviratne for the Appellant
		Milinda Gunetilleke, P.C. Additional Solicitor General with R. Gooneratne, State Counsel for the Respondent
ARGUED ON	:	27.01.2022, 01.04.2022, 20.05.2022, 30.05.202211.11.2022, & 13.12.2022

WRITTEN SUBMISSIONS FILED	:	03.02.2023 & 02.03.2021 (by the Appellant) 21.02.2023 & 24.01.2022 (by the Respondent)
DECIDED ON	:	03.05.2023

Dr. Ruwan Fernando, J.

Introduction

[1] This is an appeal by way of Stated Case against the determination made by the Tax Appeals Commission dated 26.06.2019 confirming the determination made by the Respondent dated 28.07.2016 and dismissing the appeal of the Appellant. The taxable periods related to this Appeal are from January 2011 to December 2011.

Factual Background

[2] The Appellant is a Public Limited Liability Company in Sri Lanka and it carried on the business of general insurance and life insurance in Sri Lanka. The business of the Appellant is regulated by the Regulation of Insurance Industry Act, No. 43 of 2000 (as amended). The Appellant submitted monthly VAT returns for the above-mentioned taxable periods from January 2011 to December 2011. The Appellant claimed that it is not liable to pay VAT on the supply of financial services under section 25F of the Value Added Tax Act, No. 14 of 2002 (as amended) on the basis that the value addition on business of life insurance is expressly exempted from VAT on financial services in terms of item (x) (i) of Part II (b) of the First Schedule to the Value Added Tax Act, No. 14 of 2002 (as amended) (hereinafter referred to as the VAT Act) and that the business of life insurance is not specifically enumerated in section 25F of the VAT Act so as to constitute a chargeable financial service.

[3] The assessor by letter dated 26.06.2014 refused to accept the returns on the ground that various types of interest income declared in the audited accounts of the Appellant fall under section 25F of the VAT Act and therefore the Appellant is liable to pay VAT on financial services under Chapter IIIA of the VAT Act (Vide-pp. 35-37 of the TAC brief). Accordingly, VAT on the supply of financial services was calculated by the assessor for the taxable periods from 01.01.2011-30.06.2011 and 01.07.2011-31.12.2011 and the asssessments were issued.

Appeal to the Respondent and the Tax Appeals Commission

[4] The Appellant appealed to the Respondent against the said assessments and the Respondent by its determination dated 28.07.2016 confirmed the assessments issued by the assessor (pp. 15-23).

The decision of the Tax Appeals Commission

[5] Being dissatisfied with the said determination of the Respondent, the Appellant appealed to the Tax Appeals Commission and the Tax Appeals Commission by its determination dated 25.06.2019 confirmed the determination of the Respondent and dismissed the appeal. The Tax Appeals Commission (hereinafter referred to as the TAC) held:

1. The assessments issued by the assessor are valid in law, and the assessor having given reasons for non-acceptance of assessments, duly communicated his reasons to the Appellant;
2. The interest income earned by the Appellant from the above-mentioned financial activities is part and parcel of the Appellant's main business, and that such activities constitute financial services chargeable with VAT on financial services under section 25F of the VAT Act;

3. The interest income earned by the Appellant from the investment of monies in securities and other instruments has been used to meet the commitments of its customers and thus, such investment income could be treated as business income of the Appellant.

Appeal to the Court of Appeal

[6] Being aggrieved by the decision of the TAC, the Appellant appealed to the Court of Appeal and formulated the following Nine Questions of Law in the case Stated for the opinion of the Court of Appeal.

1. Is the determination of the Tax Appeals Commission time barred?
2. Did the Tax Appeals Commission err in law when it came to the conclusion that the Appellant was liable to pay Value Added Tax on financial service?
3. Did the Tax Appeals Commission err in law when it concluded that the Appellant was liable to pay Value Added Tax on financial services but did not quantify the Appellant's liability in terms of the Act by taking into consideration section 25(5)(a) and (c) of the Value Added Tax Act, No. 14 of 2002, as amended?

4. Did the Tax Appeals Commission err in law by concluding that the Appellant is involved in the supply of financial services in terms of section 25A(1) read with section 25F of the Value Added Tax Act, No. 14 of 2002, as amended?
5. Did the Tax Appeals Commission err in law in failing to consider that the Appellant is involved in solely in the insurance business which is an industry strictly regulated by the provision of the Regulation of Insurance Industry Act, No. 43 of 2000 as amended?
6. Did the Tax Appeals Commission err in law in failing to consider that the life insurance business of the Appellant is exempted from VAT?
7. Did the Tax Appeals Commission err in law in failing to consider that the investment of the Appellant of the life insurance policy holders' monies in Treasury Bills and other similar instruments is to ensure security for the policy holder and not as granting the loan to the Government? CBSL is exempt from VAT on FS for the same supply as mentioned above (Part II of the First Schedule Item (i) of the VAT Act?
8. Did the Tax Appeals Commission err in law in failing to consider that the amount invested by the Appellant from and out of the life insurance policy holders' fund is tied to and payable to the said policy by way of contract?
9. In view of the facts and circumstances of the case, did the Tax Appeals Commission err in law when it came to the conclusion that it did?

Question of Law No. 1

Time bar of the determination made by the Tax Appeals Commission

[7] At the hearing, Mr. Nihal Fernando submitted that section 10 of the Tax Appeals Commission Act, No. 23 of 2011 as last amended by the Tax Appeals Commission (Amendment) Act, No. 20 of 2013, stipulates that the TAC shall make its determination within two hundred and seventy days from the date of the Commission commencing its sittings for the hearing of each appeal. He submitted that the amendment of section 10 of the Tax Appeals Commission Act, No. 23 of 2011 with retrospective effect on two occasions and having an avoidance of doubt clause in section 15 of the Tax Appeals Commission (Amendment) Act, No. 20 of 2013 makes it very clear that the intention of Parliament is that section 10 as amended, is a mandatory provision of law which requires strict compliance.

[8] He further submitted that though the first date of hearing of the appeal as per the TAC proceedings was 05.06.2018, the determination of the TAC was made on 25.06.2019 and thus, the determination has been made more than 270 days (one

year and 20 days) from the date of the first oral hearing, which is outside the period specified in section 10 for the determination of the appeal. His contention was that the TAC is no longer possessed of jurisdiction to continue hearing of the appeal and the determination is time barred by operation of law.

[9] He further submitted that the Tax Appeals Commission Act, No. 23 of 2011 (as amended) was intended to be a mandatory provision of law and required strict compliance and the directory provision would not have required an amendment with retrospective effect and the avoidance of doubt provision found in section 15 of the Tax Appeals Commission Act, No. 23 of 2011, if the time bar stipulated in section 10 of the Tax Appeals Commission Act, as amended, was intended to be directory.

[10] Mr. Fernando relied on the following statement made by His Lordship Gooneratne J. in *Mohideen v. Commissioner-General of Inland Revenue* (CA 2/2007 (20-15) Vol. XXI. BASL Law Journal, page 171 decided on 16.01.2014, referring to the statutory time bar applicable to the Board of Review to make a determination under the Inland Revenue (Amendment) Act, No. 37 of 2003 at p. 176:

> *"If specific time limits are to be laid down, the legislature needs to say so in very clear and unambiguous terms instead of leaving it to be interpreted in various ways. To give a restricted interpretation would be to impose unnecessary sanctions on the Board of Review.* ***It would be different or invalid if the time period exceeded two years from the date of oral hearing. If that be so, it is time barred."*** *[Emphasis added]*

[11] Mr. Nihal Fernando submitted that while the statement of Gooneratne J. regarding the applicability of the time bar would not constitute part of the ratio decidendi for this decision, it nevertheless constitutes a relevant judicial dicta which sheds light on the issue, but it cannot be regarded as a mere obiter dicta statement. He submitted that in this context, the statement of Janak de Silva, J. in *Stafford Motor Company Limited v. The Commissioner General of Inland Revenue*, CA /Tax/17/2017, decided on 15.03.2019, *Kegalle Plantations PLC v. Commissioner General of Inland Revenue*, CA/Tax 09/2017 decided on 04.09.2014 that the statement of Gooneratne, J. is an obiter dicta statement is erroneous. He relied on the decisions in *D.M.S. Fernando v. A.M. Ismail* (1982) IV Reports of Sri Lanka Tax Cases 184 and *Sampanthan v. Attorney General* SC FR 351/2018 decided on 13.12.2018 in particular, in support of his submissions.

[12] On the other hand, Mr. Milinda Gunetilleke submitted that the Court of Appeal in *Mohideen v. Commissioner-General of Inland Revenue* (supra),

considered the question of the actual date of hearing intended by Parliament in the second proviso to Section 140 (10) of the Inland Revenue (Amendment) Act, No. 37 of 2003, for the purpose of the time limit of the appeal decided by the Board of Review. He submitted that the Court held in *Mohideen v. Commissioner-General of Inland Revenue* (supra), that the hearing means the date of the actual oral hearing, which constitutes ratio decidendi and that the statement made by Gooneratne J. was only obiter dicta, and not ratio decidendi. He submitted that the Tax Appeals Commission Act does not spell out any sanction for the failure on the part of the TAC to comply with the time limit set out in section 10 of the Act. His contention was that the word "shall" in section 10 does not necessarily mean that the provision is mandatory unless non-observance will result in the object of the provision being frustrated and the sanction is statutorily spelled out in the Tax Appeals Commission Act.

[13] Mr. Gunetilleke, relied on the decisions in *Stafford Motor Company Limited v. The Commissioner General of Inland Revenue* (supra), *Kegalle Plantations PLC v. Commissioner General of Inland Revenue* (supra), *Visuvalingam v. Liyanage* 1983 (1) Sri LR 203, *Amadeus Lanka (Private) Limited v. Commissioner General of Inland Revenue* (CA/Tax/04/2019 decided on 30.07.2021), *Valibel Lanka (Pvt) Ltd v. Director General of Customs and 13 others* decided on 29.08.2008 in support of his submissions.

[14] His Lordship Janak de Silva J., referring to *Mohideen v. Commissioner-General of Inland Revenue* (supra), held in *Stafford Motor Company Limited v. The Commissioner General of Inland Revenue* (supra) that the statement made by His Lordship Gooneratne J. was an obiter dicta statement at p. 6 as follows:

> *"We are of the view that the statement in Mohideen's case* (supra) *that the determination of the Board of Review is invalid if not made within the statutory time period is obiter dicta. Accordingly, we are of the view that the determination of the TAC in the instant case is not time barred. In Kegalle Plantations PLC v. Commissioner-General of Inland Revenue [CA (TAX) 09/2017, C.A.M. 04.09.2018] we arrived at a similar conclusion".*

[15] In *Kegalle Plantations PLC v. The Commissioner-General of Inland Revenue* (supra) and *CIC Agri Business (Private) Limited v. The Commissioner-General of Inland Revenue* (CA/Tax 42/2014 decided on 29.05.2021), His Lordship Janak de Silva J. arrived at a similar conclusion.

Analysis

Statutory Provisions

[16] The time limit for the determination of the appeal by the TAC was originally contained in Section 10 of the Tax Appeals Commission Act, No. 23 of 2011, which stipulated that the Tax Appeals Commission shall make the determination within a period of one hundred and eighty days from the date of the commencement of the hearing of the appeal. It reads as follows:

> *"The Commission shall hear all appeals received by it and make its decision in respect thereof, within* ***one hundred and eighty days*** *from the date of the commencement of the hearing of the appeal".*

[17] Section 10 of the Tax Appeals Commission Act was amended by section 7 of the Tax Appeals Commission (Amendment) Act, No. 4 of 2012, which stipulated that the determination of the Commission shall be made within **two hundred and seventy days**. In terms of section 13 of the said Act, the amendment was to have retrospective effect and was deemed to have come into force from the date of the Principal Act (i.e. 31.01.2011). Section 10 of the Tax Appeals Commission Act was further amended by section 7 of the Tax Appeals Commission (Amendment) Act, No. 20 of 2013, which stipulated that the determination of the Commission shall be made within **two hundred and seventy days from the date of the commencement of its sittings for the hearing of each such appeal**. In terms of the Tax Appeals Commission (Amendment) Act, No. 4 of 2012 (s. 13) and the Tax Appeals Commission (Amendment) Act, No. 20 of 2013 (s. 14), the amendments made to the provision of section 10 were given retrospective effect.

[18] Section 15 of the Tax Appeals Commission (Amendment) Act, No. 20 of 2013 further provides an avoidance of doubt clause as follows:

> *"For the avoidance of doubts, it is hereby declared, that the Commission shall have the power in accordance with the provisions of the principal enactment as amended by this Act, to hear and determine any appeal that was deemed transferred to the Commission under section 10 of the principal enactment, notwithstanding the expiry of the twelve months granted for its determination by that section prior to its amendment by this Act."*

[19] Accordingly, section 10 of the Tax Appeals Commission Act, No. 23 of 2011 as last amended by the Tax Appeals Commission (Amendment) Act, No. 20 of 2013 now provides as follows:

> *"The Commission shall hear all appeals received by it and make its determination in respect thereof, within* ***two hundred and seventy days from***

the date of the commencement of its sittings for the hearing of each such appeal*:*

Provided that, all appeals pending before the respective Board or Boards of Review in terms of the provisions of the respective enactments specified in Column I of Schedule I, or Schedule II to this Act, notwithstanding the fact that such provisions are applicable to different taxable periods as specified therein shall with effect from the date of coming into operation of the provision of this Act be deemed to stand transferred to the Commission, and the Commission shall notwithstanding anything contained in any other written law make its determination in respect thereof, within twenty four months from the date on which the Commission shall commence its sittings for the hearing of each such appeal".

[20] In the present case, Mr. Nihal Fernando conceded that the statement made by Gooneratne J. in *Mohideen v. The Commissioner-General of Inland Revenue* (supra) would not constitute a ratio decidendi, but it is a relevant judicial dicta which cannot be regarded as a mere obiter statement. Thus, it is not in dispute that the statement of Gooneratne J. is not a ratio decidendi for the present case. The relevance of the statement must be, however, considered in the context of the facts and the circumstances of the case and the relevant legal provisions that existed at that time.

Mandatory and Directory Provisions

[21] I shall now proceed to consider the submission of Mr. Nihal Fernando, referring to the word "shall" in section 10 that the time bar in section 10 of the Tax Appeals Commission Act is a mandatory provision of law which requires strict compliance. Section 10 of the Tax Appeals Act stipulates that the TAC shall make its determination within 270 days from the date of the commencement of its sittings for the hearing of the appeal. Superficially, the effect of non-compliance of a provision is dealt with in terms of the mandatory-directory classification. Generally, in case of a mandatory provision, the act done in breach thereof is void, whereas, in case of a directory provision, the act does not become void, although some other consequences may follow (P.M. Bakshi, Interpretation of Statutes, First Ed, 2008422).

[22] In my view, the use of the word "shall" does not always mean that the provision is obligatory or mandatory as it depends upon the context in which the word "shall" occurs, and the other circumstances as echoed by the Indian Supreme

Court case of *The Collector of Monghyr v. Keshan Prasad Goenka*, AIR 1962 SC 1694 at p. 1701) in the following words:

> *"It is needless to add that the employment of the auxiliary verb "shall" is inconclusive and similarly the mere absence of the imperative is not conclusive either. The question whether any requirement is mandatory or directory has to be decided not merely on the basis of any specific provision which, for instance, sets out the consequence of the omission to observe the requirement, but on the purpose for which the requirement has been enacted, particularly in the context of the (1) [1958] S.C.R. 533, other provisions of the Act and the general scheme thereof. It would, inter alia, depend on whether the requirement is insisted on as a protection for the safeguarding of the right of liberty of a person or of property which the action might involve".*

[23] It is well-established that an enactment in form mandatory, might in substance be directory and that the use of the word "shall" does not conclude the matter (*Hari Vishnu Kamath v. Ahmad Ishaque* AIR 1955 SC 233 referring to *Julius v. Bishop of Oxford* (1880) 5 A.C. 214 HL). Section 10 of the Tax Appeals Commission Act does not say what will happen if the Commission fails to make the determination within the time limit specified in Section 10 of the Tax Appeals Commission Act, No. 23 of 2011 (as amended). Mr. Fernando, referring to the five-judge decision of *D.M.S. Fernando and another v. A.M. Ismail* (1982) IV Reports of Sri Lanka Tax Cases 184, 193 submitted that penal consequences need not be laid down in order for a provision to be held mandatory and that in such case, the Court has to consider the natural consequences that would follow where Parliament had not prescribed a sanction for breach of a mandatory provision. He referred to the proposition of law that was lucidly explained by Samarakoon C.J, at pp.184, 190 wherein His Lordship stated as follows:

> *"The statute itself contains no sanction for a failure to communicate reasons. If it had the matter would be easy of decision. But the matter does not rest there. One has to make a further inquiry. "If it appears that Parliament intended disobedience to render the Act invalid, the provision in question is described as "mandatory", "imperative" or "obligatory"; if on the other hand, compliance was not intended to govern the validity of what is done, the provision is said to be "directory" (Halsbury's Laws of England, Ed 3 Vol. 36-page 434 S. 650). Absolute provisions must be obeyed absolutely whereas directory provisions may be fulfilled substantially (Vide- Woodward vs. Sarson (1875) (L.R.10 cp 733 at 746). No universal rule can be laid down for determining whether a provision is mandatory or directory. "It is the duty of Courts of Justice to try to get at the intention of the legislature by carefully attending to the whole scope*

of the Statute to be construed per Lord Campbell in Liverpool Borough Bank vs Turner (1860) (2 De CF. & J 502 at 508) Vita Food Products vs. Unus Shipping Co. (1939 A.C. 377 at 393). Each Statute must be considered separately and in determining whether a particular provision of it is mandatory or directory one must have regard "to the general scheme to the other sections of the Statute". The Queen vs. Justices of the County of London County Council (1893) 2 Q.B. 476 at 479). It is also stated that considerations of convenience and justice must be considered. Pope vs. Clarke (1953) (2 A.E.R. 704 at 705). Then again, it is said that to discover the intention of the Legislature it is necessary to consider-(1) The Law as it stood before the Statute was passed. (2) The mischief if any, under the old law which the Statute sought to remedy and (3) the remedy itself. (Maxwell on Interpretation of Statutes, Edition 12 page 160). These are all guidelines for determining whether Parliament intended that the failure to observe any provision of a Statute would render an act in question null and void. They are by no means easy of application and opinions are bound to differ. Indeed, some cases there may be where the dividing line between mandatory and directory is very thin. But the decision has to be made. I will therefore examine the Statute bearing in mind these guidelines".

[24] I agree with Mr. Fernando that the absence of any provision does not necessarily follow that the statutory provision is intended by the legislature to be disregarded or ignored. Where the sanction for not obeying them in every particular statute is not prescribed, the Court must judicially determine them to ascertain whether the legislature intended that the failure to observe any provision of a Statute would render an act null and void, or leave it intact (see also, N.S. Bindra's Interpretation of Statute, 10th Ed. p. 1013).

Legislative Intent

[25] The question as to whether a statute is mandatory or directory is a question which has to be adjudged in the light of the intention of the Legislature as disclosed by the object, purpose and scope of the statute. If the statute is mandatory, the act or thing done not in the manner or form prescribed can have no effect or validity, and if it is directory, a penalty may be incurred for non-compliance, but the act or thing done is regarded as good (P.M. Bakshi, Interpretation of Statutes, p. 430 & *Mohanlal Ganpatram v. Shri Sayaji Jubliee Cotton and Jute Mills Co. Ltd* AIR 1966 Guj. 96). In *State of U.P., v. Baburam Upadhya*, AIR 1961 SC 751, the Supreme Court of India stated that when a statute uses the word "shall", prima facie, it is mandatory, but the Court may ascertain the real intention of the legislature by carefully attending to the whole scope of the

statute. Crawford on "Statutory Construction" (Ed. 1940, Art. 261, p. 516) sets out the following passage from an American case approvingly as follows:

> "*The question as to whether a statute is mandatory or directory depends upon the intent of the legislature and not upon the language in which the intent is clothed. The meaning and intention of the legislature must govern, and these are to be ascertained, not only from the phraseology of the provision, but also by considering its nature, its design, and the consequences which would follow from construing it the one way or the other*".

[26] According to Sutherland, Statutory Construction, Third Ed. Vol. III, p. 77:

> *"The difference between mandatory and directory statutes is one of effect only. The question generally arises in a case involving a determination of rights as affected by the violation of, or omission to adhere to statutory directions. This determination involves a decision of whether or not the violation or omission is such as to render invalid Acts or proceedings to the statute, or rights, powers, privileges claimed thereunder. If the violation or omission is invalidating, the statute is mandatory, if not, it is directory".*

[27] Then, the question is this: What is the fundamental test that is to be applied in determining whether or not the failure to obey the time bar provision in section 10 of the Tax Appeals Commission Act was intended by the legislature to be mandatory or directory? This question ultimately depends on the consideration of whether the consequences of the non-compliance were intended by the legislature to be mandatory or directory. This proposition was echoed by Lord Woolf MR (as he then was) in *R v. Secretary of State for the Home Department, Ex p Jeyeanthan* [2000] 1 WLR 354, who stated that it is "much more important to focus on the **consequences of the non-compliance**". He elaborated this proposition in the following words at p. 360:

> *"In the majority of cases, whether the requirement is categorised as directory or mandatory, the tribunal before whom the defect is properly raised has the task of determining what are to be the consequences of failing to comply with the requirement in the context of all the facts and circumstances of the case in which the issue arises".*

[28] Here, it is also desirable to remember the words of Lord Hailsham of St. Marylebone L.C. in his speech in *London and Clydeside Estates Ltd. v. Aberdeen District Council* [1980] 1 W.L.R. *182* , 188–190. He stated at p. 36:

"The contention was that in the categorisation of statutory requirements into 'mandatory' and 'directory,' there was a subdivision of the category 'directory' into two classes composed (i) of those directory requirements 'substantial compliance' with which satisfied the requirement to the point at which a minor defect of trivial irregularity could be ignored by the court and (ii) those requirements so purely regulatory in character that failure to comply could in no circumstances affect the validity of what was done.

When Parliament lays down a statutory requirement for the exercise of legal authority, it expects its authority to be obeyed down to the minutest detail. But what the courts have to decide in a particular case is the ***legal consequence of non-compliance on the rights of the subject viewed in the light of a concrete state of facts and a continuing chain of events"***.

[29] In *Howard and Others v. Bodington* (1877) 2 PD 203, the Court of Arches considered the question whether the consequences of a failure to comply with a statutory requirement are mandatory or directory. Lord Penzance stated at pp. 211-212:

"Now the distinction between matters that are directory and matters that are imperative is well known to us all in the common language of the courts at Westminster. I am not sure that it is the most fortunate language that could have been adopted to express the idea that it is intended to convey; but still, that is the recognised language, and I propose to adhere to it. ***The real question in all these cases is this: A thing has been ordered by the legislature to be done. What is the consequence if it is not done?*** *In the case of statutes that are said to be imperative, the Courts have decided that if it is not done the whole thing fails, and the proceedings that follow upon it are all void. On the other hand, when the Courts hold a provision to be mandatory or directory, they say that, although such provision may not have been complied with, the subsequent proceedings do not fail. Still, whatever the language, the idea is a perfectly distinct one. There may be many provisions in Acts of Parliament which, although they are not strictly obeyed, yet do not appear to the Court to be of that material importance to the subject-matter to which they refer, as that the legislature could have intended that the non-observance of them should be followed by a total failure of the whole proceedings. On the other hand, there are some provisions in respect of which the Court would take an opposite view, and would feel that they are matters which must be strictly obeyed, otherwise the whole proceedings that subsequently follow must come to an end".*

[30] In the absence of any express provision, the intention of the legislature is to be ascertained by weighing the consequences of holding a statute to be directory or mandatory having regard to the importance of the provision in relation to the

general object intended to be secured by the Act *(Caldow v. Pixcell* (1877) 1 CPD 52, 566) & *Dharendra Kriisna v. Nihar Ganguly* (AIR 1943 Cal. 266). As held in *Attorney General's Reference (No 3 of 1999),* the emphasis ought to be on the consequences of non-compliance, and asking the question whether Parliament can fairly be taken to have intended total invalidity.

[31] Now the question is, to which category, does section 10 in this case belong? The question as to whether section 10 is mandatory or directory depends on the intent of the legislature, and not upon its language, irrespective of the fact that section 10 is couched in language which refers to the word "shall". The intention of the legislature must be ascertained not only from the phraseology of section 10, but also by considering its purpose, its design and more importantly, the consequences which would follow from construing it one way of another. It is necessary to ask the question: What is the consequence of the failure to adhere to the time limit specified by section 10 that has been intended by the legislature to be categorised as mandatory or directory? That is how I would approach this question, which is ultimately a question of statutory construction of section 10 of the Tax Appeals Commission Act. Accordingly, one has to identify the tests to be applied in deciding whether a provision is to be regarded as mandatory or directory, and then apply them to the statute which stipulates the determination shall be made within the time limit specified therein, but makes no reference to any penal consequences.

Consequence of non-compliance with a statutory provision

[32] In considering a procedural requirement from this angle, a Court is likely to construe it as mandatory if it seems to be of particular importance in the context of the enactment, or if it is one of a series of detailed steps, perhaps in legislation which has created a novel jurisdiction (*Warwick v. White* (1722) Bunb. 106; 145 E.R. 612) or if non-compliance might have entailed penal consequences for one of the parties (*State of Jammu and Kashmir v. Abdul Ghani* (1979) Ker LJ 46). Where the disobedience of a provision is made penal, it can safely be said that such provision was intended by the legislature to be mandatory (*Seth Banarsi Das v. The Cane Commissioner* & Another, AIR 1955 All 86). As noted, the fact that no penal consequence is stated in a statute, however, is only one factor to be considered towards a directory construction, and there are other factors to be considered in determining whether a provision of a statute is mandatory or not. One of the factors in determining whether the consequence of non-compliance provision was intended by the legislature to be mandatory or directory is to consider the broad

purpose and object of the statute as Lord Penzance stated in *Howard v. Bodington* (supra) at 211 as follows:

> *"I believe, as far as any rule is concerned, you cannot safely go further than that in each case you must look to the subject-matter: consider the importance of the provision that has been disregarded, and the relation of that provision to the general object intended to be secured by the Act; and upon a review of the case in that aspect decide whether the matter is what is called imperative or only directory."*

Purpose of the section in the context of the statute

[33] The legislature is a purposive act, and judges should construe statutes to execute that legislative purpose, intent and context (Robert A. Katzmann, Judging Statutes 31 (2014) by focusing on the legislative process, taking into account the problem that the legislature was trying to solve (Henry M. Hart, Jr. & Albert M. Sacks, "The legal Process: Basic Problems in the Making and Application of Law" 1182 (William N. Eskridge, Jr. & Phillip P. Frickey Eds., (1994). We must thus, ascertain what the legislature was trying to achieve by amending the Tax Appeals Commission Act twice as far as the time bar is concerned. Mr. Fernando contended that, given the tax law context, a strict approach to the construction of section 10 of the Tax Appeals Commission Act should be adopted as the amendment of the Tax Appeals Commission Act with retrospective operation twice would reflect the legislative intent that the compliance with section 10 is mandatory. He argued that if the time bar stipulated in section 10 was intended to be directory, the amendment of section 10 of the Tax Appeals Commission Act with retrospective effect on two occasions, and the avoidance of doubt clause found in section 15 of the Tax Appeals Commission (Amendment) Act, No. 20 of 2013 would have been superfluous.

[34] Will the amendment of section 10 with retrospective operation twice manifest the intention of the legislature that the failure of the TAC to make its determination within the time limit specified in section 10 is mandatory? From section 15, it is manifest that the legislature intended section 10 to operate retrospectively, so that the date of the commencement of section 10 is earlier than the date of that amendment. A legislative intention to amend section 10 with retrospective operation does not necessarily or conclusively mean that the failure to make the determination of the TAC within the time limit specified in section 10 is mandatory. If such drastic consequence was really intended by the legislature, it would have made appropriate provisions in express terms in section 10 to the

effect that "the appeal shall be deemed to have been allowed where the Tax Appeals Commission fails to adhere to the time limit specified in section 10 of the Tax Appeals Commission Act.

[35] There are guidelines in tax statutes, which stipulate that the failure to observe any time limit provision would render the appeal null and void or that the appeal shall be deemed to have been allowed. For example, Section 165 (14) of the Inland Revenue Act, No. 10 of 2006 (as amended), provides that "an appeal preferred to the Commissioner-General shall be agreed to, or determined by the Commissioner-General within a period of two years from the date on which such petition of appeal is received...". The same section specifically stipulates that "where such appeal is not agreed to or determined within such period, the appeal shall be deemed to have been allowed and tax charged accordingly".

[36] An identical provision is contained in section 34 (8) of the VAT Act, No. 14 of 2002 as well, which stipulates that "where such appeal is not agreed to, or determined within such period, the appeal shall be deemed to have been allowed and the tax charged accordingly". Although the Tax Appeals Commission Act was amended by Parliament twice and increased the period within which the appeal is to be determined by the Commission from 180 days to 270 days with retrospective effect, the legislature in its wisdom did not specify any penal consequence or any other consequence of non-compliance of the time bar specified in section 10 of the Tax Appeals Commission Act. Had the legislature intended that the non-compliance with section 10 to be mandatory, it could have easily included a provision with negative words requiring that an act shall be done in no other manner or at no other time than that designated in the section or a provision for a penal consequence or other consequence of non-compliance. This proposition was echoed by FOTH, C. J. in the Supreme Court of Kansas decision in *Paul v. The City of Manhattan*, 511 P.2d (1973) 212 Kan. 381, paragraph 17 as follows:

> *"The language of the enactment itself may provide some guidance. Thus, we said in Shriver v. Board of County Commissioners, 189 Kan. 548, 370 P. 2d 124, "Generally speaking, statutory provisions directing the mode of proceeding by public officers and intended to secure order, system and dispatch in proceedings, and by a disregard of which the rights of parties cannot be injuriously affected, are not regarded as mandatory, unless accompanied by negative words importing that the acts required shall not be done in any other manner or time than that designated". (p. 556. Emphasis added). A critical feature of mandatory legislation is often a provision for the consequences of*

non-compliance. This element was noticed by early legal commentators, for in Bank v. Lyman, supra, we find this observation (p. 413)."

[37] Bindra's Interpretation of Statutes, 10th Ed., referring to the decision of *Paul v. The City of Manhattan* (supra), states that factors which would indicate that the provisions of a Statute or Ordinance are mandatory are: (1) the presence of negative words requiring that an act shall be done in no other manner or at no other time than that designated; or (2) a provision for a penalty or other consequence of non-compliance (p. 433). The legislature in its wisdom has placed time limit for the speedy disposal of appeals filed before the Commissioner-General and the overall legislative intention sought to be attained by the Inland Revenue Act in section 165 (14) was to ensure that an appeal before the Commissioner-General of Inland Revenue is disposed of within a period of 2 years from the date on which the Petition of Appeal is received. As the Commissioner-General is an interested party against another interested party (tax payer) in the tax collection, it shall determine the appeal within 2 years from the receipt of the Petition of Appeal, and if not, the appeal shall be deemed to have been allowed and tax charged accordingly, so as to safeguard the rights of the taxpayer

[38] Mr. Fernando referred to the following statement made by H.N.J. Perera CJ in the majority judgment of seven judge bench of the Supreme Court in *Sampanthan v. Attorney General* (supra). Wherein the Supreme Court stated:

"Next, it is to be kept in mind that the task of interpreting a statute must be done within the framework and the wording of the statute and in keeping with the meaning and intent of the provisions in the statute. A Court is not entitled to twist or stretch or obfuscate the plan and clear meaning and effect of the words in a statute to arrive at a conclusion which attracts the Court".

[39] In identifying the legislative intention, it is necessary to consider the amendments made to the Tax Appeals Commission Act, to ascertain whether the provision of section 10 was intended to be mandatory by the legislature for the purpose of the application of the proposition of law made in *Sampanthan v. Attorney General* (supra). The object sought to be attained by section 10 of the Tax Appeals Commission Act has been designed primarily, to expedite the appeal process filed before the TAC, which was established by an Act of Parliament comprising retired Judges of the Supreme Court or the Court of Appeal and those who have gained wide knowledge and eminence in the field of Taxation.

[40] Section 10 of the Tax Appeals Commission Act, No. 23 of 2011 granted time to the TAC to hear all appeals within one hundred and eighty days from the date

of the commencement of the hearing of the appeal. The Tax Appeals Commission (Amendment) Act, No. 4 of 2012 extended the said time period from one hundred and eighty days to two hundred and seventy days from the date of the commencement of the hearing of the appeal. The Tax Appeals Commission (Amendment) Act, No. 20 of 2013 however, reduced the time limit granted to the TAC to conclude the appeal by enacting that the time specified in section 10 shall commence from the date of the commencement of its sittings for hearing the appeal. The legislature has, from time to time, extended and reduced the time period within which the appeal shall be determined by the TAC, but it intentionally and purposely refrained from imposing any consequence for the failure on the part of the TAC to adhere to the time limit specified in section 10.

[41] The legislature amended the Tax Appeals Commission Act twice with retrospective effect, and provided time frames to conclude appeals quickly as possible within the time limit of 270 days from the date of the commencement of its sittings for the hearing of such appeal. It is true that the legislature has amended section 10 with retrospective operation but if it intended to take away the jurisdiction of the TAC, and render its determination made outside the time limit specified in section 10 invalid, it could have easily made, with retrospective effect, appropriate provision in express terms that the appeal shall be deemed to have been allowed or other consequence of non-compliance.

[42] It is settled law that Courts cannot usurp legislative function under the disguise of interpretation and rewrite, recast, reframe and redesign the Tax Appeals Commission Act, because this is exclusively in the domain of the legislature. This proposition was lucidly explained by Lord Simonds in *Magor and St Mellons Rural District Council v. Newport Corporaion* [1951] 2 All ER 839, HL. Referring to the speech of Lord Denning MR, Lord Simonds said at page 841: "It appears to me to be a naked usurpation of the legislative function under the thin disguise of interpretation", Lord Simonds further stated at 841:

> *"The duty of the court is to interpret the words that the legislature has used; those words may be ambiguous, but, even if they are, the power and duty of the court to travel outside them on a voyage of discovery are strictly limited. If a gap is disclosed, the remedy lies in an amending Act and not in a usurpation of the legislative function under the thin disguise of interpretation".*

[43] The same proposition was echoed by Arijit Pasayat, J. in the Indian Supreme Court case of *Padmasundara Rao and Ors. v. State of Tamil Nadu and Ors.* AIR (2002) SC 1334, at paragraph 14, as follows:

"14. While interpreting a provision, the Court only interprets the law and cannot legislate it. If a provision of law is misused and subjected to the abuse of process of law, it is for the legislature to amend, modify or repeal it, if deemed necessary".

[44] On the other hand, the proviso to Section 10 of the Tax Appeals Commission Act, No. 23 of 2011 granted time for the Commission to make its determination in respect of appeal transferred to the Commission from the Board of Review within a period of one hundred and eighty days (180) from the date of such transfer, notwithstanding anything contained in any other written law. The Tax Appeals Commission (Amendment) Act, No. 4 of 2012 extended the said time period from one hundred and eighty days to twelve months of the date on which the Commission shall commence its sittings. (Vide-Section 7 of the Act, No. 4 of 2012). The Tax Appeals Commission (Amendment) Act, No. 20 of 2013 extended the said time period to twenty-four months from the date on which the Commission shall commence its sittings for the hearing of each such appeal.

[45] It is crystal clear that these procedural time limit rules in respect of appeals received by the Tax Appeals Commission or appeals transferred from the Board of Review to the Commission have been devised by the legislature to facilitate the appeal process by increasing and reducing the time period within which such appeals shall be concluded. The provision for the determination of an appeal by the TAC within a period of 270 days from the commencement of its sittings for the hearing of an appeal has been designed with a view to regulating the duties of the TAC by specifying a time limit for its performance as specified in section 10 of the Act. So that the legislature, in its wisdom has made provision in section 10 to the effect that the appeal shall be disposed of speedily within a period of 270 days from the date of the commencement of the sittings for the hearing of the appeal. But the legislature imposed no drastic and painful penal consequence or other consequence of non-compliance, including prohibitory or negative words in section 10, rendering the determination of the appeal null and void for non-compliance of the time limit specified in section 10. In my view, they are not intended to make the parties suffer from the failure of the Commission to make the determination within the time limit specified in section 10 of the Tax Appeals Commission Act.

[46] Any procedural retrospective operation of a provision, in my view, cannot take away the rights of parties who have no control over those entrusted with the duty

of making determination within the time limit specified in section 10. The retrospective operation of section 10 without any penal or other consequence of non-compliance, by itself, cannot be treated as a factor in determining that the legislature intended that the failure to adhere to the time limit specified in section 10 is mandatory.

Avoidance of doubt clause

[47] Mr. Fernando, further relied on the avoidance of doubt clause in Section 15 of the Tax Appeals Commission Act to argue that section 15 would be rendered nugatory if the provisions of section 10 are considered to be directory. A perusal of section 15 of the Tax Appeals Commission (Amendment) Act, No. 20 of 2013 reveals that it relates to appeals that have been transferred to the Commission from the Board of Review, and provides that the TAC shall have the power to make a determination in respect thereof, beyond twelve months granted for its determination of appeals by the Inland Revenue (Amendment) Act No. 23 of 2011.

[48] It seems to me that the avoidance of doubt clause in section 15 applies to appeals transferred from the Board of Review and not to new appeals directly filed before the TAC. On the other hand, the intention of the legislature in section 15 is to empower the Commission to hear an appeal transferred to it by the Board of Review under section 10 of the Act, notwithstanding the expiry of the twelve months granted for its determination by the Tax Appeals (Amendment) Act, No. 4 of 2012. It seems to me that section 15 manifests that the legislature never intended that the time period specified in the general scheme of the Tax Appeals Commission Act to be mandatory, and holding otherwise, would not promote the main object of the legislature reflected in the Act.

Consequences of non-compliance with a statute by those entrusted with public duty

[49] The other important factor that is necessary to consider, whether a provision is mandatory or directory is to find as to who breached the time limit specified in section 10-whether it was breached by one of the parties to the action, or by those entrusted with the performance of a public duty. Also coming under this head are cases where the Court will take into account the practical inconveniences or impossibilities of holding a time limit requirement to be mandatory where the public duty is performed by a public body. If the statutory provision relates to the performance of a public duty, the Court is obliged to consider whether any

consequence of such breach would work serious public inconvenience, or injustice to the parties who have no control over those entrusted with such public duty.

[50] The Tax Appeals Commission Act has imposed a duty on the TAC to make the determination within the time limit specified in section 10. However, it is to be noted that the parties had no control over those entrusted with the task of making the determination within the time limit specified in section 10. Should the parties who have no control over those entrusted with the task of making the determination be made to suffer for any failure or delay on the part of the TAC in not making its determination within the time limit specified in Section 10? I do not think that the legislature intended that the time limit specified in section 10 is mandatory where the parties had no control over those entrusted with the task of making the determination within the time limit specified in section 10.

[51] Maxwell, Interpretation of Statute, 11th Ed. at page 369 referring to the ascertaining of the intention of the legislature in relation to the interpretation of limitation provision states:

> *"On the other hand, where the prescriptions of a statute relate to the performance of a public duty and where the invalidation of acts done in neglect of them would work serious general inconvenience or injustice to persons who have no control over those entrusted with the duty without promoting the essential aims of the Legislature, such prescriptions seem to be generally understood as mere instructions for the guidance and government of those on whom the duty is imposed, or, in other words, as directory only. The neglect of them may be penal, indeed, but it does not affect the validity of the act done in disregard of them. It has often been held, for instance, where an Act ordered a thing to be done by a public body or public officers and pointed out the specific time when it was to be done, then the Act was directory only and might be complied with after the prescribed time".* ***[Emphasis added]***

[52] Where the statute imposes a public duty on persons and to treat, as void, acts done without compliance with the statute would cause serious inconvenience to persons who have no control over those entrusted with this duty, then the practice is to hold the provision to be directory only so as not to affect the validity of such action taken in breach of such duty (*Montreal Street Rly. Co. v. Normandin* (1917) AC 170, 175). Lord Sir Arther Channell echoed this proposition in that case at p. 176 as follows:

> *"When the provisions of a statute relate to the performance of a public duty and the case is such that to hold null and void acts done in neglect of this duty would work serious general inconvenience, or injustice to persons who have no*

control over those entrusted with the duty, and at the same time would not promote the main object of the Legislature, it has been the practice to hold such provisions to be directory only, the neglect of them, though punishable, not affecting the validity of the acts done. This principle has been applied to provisions for holding sessions at particular times and places (2 Hale, P. C., p. 50, Rex v. Leicester Justices (1827) 7 B & C. 6 and Parke B. in Gwynne v. Burnell (1835) 2 Bing. N.C. 7); to provisions as to rates (Reg. v. Inhabitants of Fordham (1839) 11 Ad. & E. 73 and Le Feuvre v. Miller (1857) 26 L.J. (M.C.) 175); to provisions of the Ballot Act (Woodward v. Sarsons (1875) L.R. 10 C.P. 733 and Phillips v. Goff (1886) 17 Q.B.D. 805); and two justices acting without having taken the prescribed oath, whose acts are not held invalid (Margate Pier Co. v. Hannam (1819) 3 B. & Al. 266)".

[53] This proposition is further confirmed by Sutherland's Statutory Construction, Third Ed. Vol. 3. at p. 102 as follows:

"A statute specifying a time within which a public officer is to perform an official act regarding the rights and duties of others is directory unless the nature of the act to be performed, or the phraseology of the statute, is such that the designation of time must be considered a limitation of the power of the Officer". At p. 107 it is pointed out that a statutory direction to private individuals should generally be considered as mandatory and that the rule is just the opposite to that which obtains with respect to public officers. Again, at p. 109, it is pointed out that often the question as to whether a mandatory may be directory construction should be given to a statutory provision may be determined by an expression in the statute itself of the result that shall follow the non-compliance with the provision...."

[54] In the present case, the duty to make the determination within the time limit specified in Section 10 is statutorily entrusted to the members of the TAC in terms of the provisions of the Tax Appeals Commission Act, No. 23 of 2011 (as amended), and the parties had no control whatsoever, over the TAC. As Lord Sir Arther Channell put it correctly, it would cause the greatest injustice to both parties who had no control over those entrusted with the duty of making the determination, if we hold that the neglect to observe the time limit specified in section 10 of the statute renders the determination made by the Commission *ipso facto* null and void.

[55] In my view, every limitation period within which an act must be done, is not necessarily a prescription of the period of limitation with painful and drastic consequences and the parties who have no control of those entrusted with a statutory duty and no fault of them should not be made to suffer and lose their rights for the failure to adhere to the time limitation specified in a provision.

[56] In *Visuvalingam v. Liyanage* [(1985) 1 Sri LR 203], the Supreme Court was called upon to consider the question whether the time limit of two months set out in Article 126 (5) of the Constitution is mandatory or directory. The Supreme Court by a majority decision held that the provisions of Article 126 (5) of the Constitution are merely directory and not mandatory. Samarakoon, C.J stated at page 226 that:

> *"An examination of the relevant provisions of the Constitution indicates that the provision is merely directory.....These provisions confer a right on the citizen and a duty on the Court. If that right was intended to be lost because the Court fails in its duty, the Constitution would have so provided. It has provided no sanction of any kind in case of such failure. To my mind it was only an injunction to be respected and obeyed, but fell short of punishment if disobeyed. I am of the opinion that the provisions of Article 126 (5) are directory and not mandatory. Any other construction would deprive a citizen of his fundamental right for no fault of his. While I can read into the Constitution a duty of the Supreme Court to act in a particular way I cannot read into it any deprivation of a citizen's guaranteed right due to circumstances beyond his control"*

[57] Although the decision in *Visuvalingam v. Liyanage* (supra) was a case of infringement of the fundamental rights of a citizen, in my view, the rationale of the statement of Samarakoon C.J. equally applies to the facts of the present case. The decision in *Visuvalingam v. Liyanage* (supra) is further confirmed by Sharvananda J. (as he then was) in *Nagalingam v. Lakshman de Mel* (78 NLR 231), which is not a fundamental right case. The question before His Lordship was whether the provisions of section 2 (2) (c) of the Termination of Employment of Workmen (Special Provisions) Act, No. 45 of 1971 are mandatory or directory. His Lordship Sharvananda J. (as he then was) stated at page 237:

> *"The object of the provision relating to time limit in section 2(2)(c) is to discourage bureaucratic delay. That provision is an injunction on the Commissioner to give his decision within the 3 months and not to keep parties in suspense. Both the employer and the employee should, without undue delay, know the fate of the application made by the employer. But the delay should not render null and void the proceedings and prejudicially affect the parties, as the parties have no control over the proceedings. It could not have been intended that the delay should cause a loss of the jurisdiction that the Commissioner had, to give an effective order of approval or refusal. In my view, a failure to comply literally with the aforesaid provision does not affect the efficacy or finality of the Commissioner's order made thereunder. Had it been the intention of Parliament to avoid such orders, nothing would have been simpler than to have so stipulated".*

[58] If we interpret the legislative intent of Section 10 from its mere phraseology, without considering the nature, purpose, the design, the absence of consequences of non-compliance and practical impossibility, which would follow from construing it one way or the other, it will tend to defeat the overall object, design, the purpose and spirit of the Tax Appeals Commission Act. If we hold that the determination of the Commission is null and void, it will cause serious injustice to parties who have no control over those entrusted with the duty of discharging functions under the Tax Appeals Commission Act.

[59] For those reasons, I hold that having considered the facts and he circumstances and legal principles, the failure to adhere to the time limit specified in section 10 was not intended by the legislature to be mandatory with painful and drastic consequences of rendering such determination null and void. The directory interpretation of section 10 is consistent with the object, purpose and design of the Tax Appeals Commission Act, which is reflected in the intention of the legislature.

[60] With regard to the relevance of the judicial dicta referred to by Mr. Fernando in *Mohideen v. Commissioner-General of Inland Revenue* (supra), it is to be noted that the relevant question of law No. 2 in respect of which the above statement was made by Gooneratne J. in *Mohideen v. Commissioner-General of Inland Revenue* (supra) reads as follows:

> *"Has the Board of Review erred in law by violating the "spirit and intentions" of the first proviso to section 140 (10) of the Inland Revenue Act, No. 38 of 2000 (as amended by Section 52 of Inland Revenue (Amendment) Act, No. 37 of 2003), which makes it imperative that the Board of Review arrives at its determination within two years of the commencement of the hearing of this appeal?"*

[61] Section 140 (10) of the Inland Revenue Act, No. 38 of 2000 (as amended) by Section 52 of the Inland Revenue (Amendment) Act, No. 37 of 2003 contains 2 provisos, and the intention as regards time limit is reflected in the second proviso to section 140 (10), which reads as follows:

> *"Provided, however, the Board shall make its determination or express its opinion as the case may be,* ***within two years*** *from the date of commencement of the hearing of such appeal."*

[62] It is to be observed that unlike in the Inland Revenue (Amendment) Act, No. 37 of 2003, which had given a period of almost **2 years to the Board of Review** to conclude an appeal from the date of commencement of the hearing, the

legislature in section 10 of the Tax Appeals Commission Act, No. 23 of 2011 (as amended), has reduced the period within which determination shall be made by the Tax Appeals Commission viz. 270 days from the commencement of its sittings for the hearing of the appeal.

[63] The Appellant in *Mohideen v. Commissioner-General of Inland Revenue* (supra) has referred to the Budget speech made by the Minister in charge of the subject while presenting the Inland Revenue (Amendment) Act, No. 37 of 2003 in Parliament, wherein, a reference has been made that "The final settlement of questions of fact, including the Board of Review will be within 04 years" (Vide- p. 176). Based on the Budget speech, the Appellant's main argument in *Mohideen v. Commissioner-General of Inland Revenue* (supra) as regards the time bar, has been reproduced by His Lordship Gooneratne J. referring to paragraphs 2 and 4 of the written submissions of the Appellant as follows:

> *"3. Therefore, the clear legislative intention was to ensure that an appeal against an assessment is disposed of within a total period of four years (i.e. two years for the appeal to be determined by the Commissioner-General of Inland Revenue and two further years for the appeal to be determined by the Board of review resulting in a total period of four years).;*
>
> *4.The instant appeal was taken up for an oral hearing only on 17.02.2006 which is almost 6 ½ years since it was filed. It is submitted that the definition of the word "hearing" as used in the second proviso to section 140 (10) must be interpreted having regard to the legislative intention of disposing of matters before the Board of Review speedily. It would be contrary to the legislative intention (and the Board of Review would be at liberty to make even twenty-five years before orally hearing an appeal) if the operation date for the commencement of the time bar was construed to be the date of the oral hearing...."*

[64] Based on the said written submissions, His Lordship Gooneratne J. identified and referred to the Appellant's main point for the determination of the Court at page 177 of the judgment as follows:

> *"The Appellant's view is that commencement of the time bar will operate from the date on which he submitted to the jurisdiction of the Board. That would be according to the Appellant on receipt of the Petition of Appeal by the Board and not from the date of the oral hearing. Emphasis on this point is by reference to 140 (10) of Act No. 38 of 2000. <u>As such Appellant submits it is the intention of the legislature that all of it should be concluded in 2 years and in the instant case it took 6 ½ years since filing the petition.</u>" [Emphasis added]*

[65] Referring to section 140 (10), His Lordship Gooneratne J. states as follows:

"*Based on Section 140 of the Act, No. 38 of 2000, the legislature intended the word 'hearing' to mean an oral hearing; .....*

Section 140 (10) provides that the Board shall confirm, reduce, increase or annul the assessment 'after the hearing' of the Appeal. It is therefore patently evident that the word "hearing" used consistently in Section 140 of Act No. 38 of 2000 means an "oral hearing" and no more".

[66] It is manifest that the main argument advanced by Dr. Shivaji Felix before Gooneratne J. was that as the legislative intention was to dispose of both appeals within **a total period of four years and** the time limit of 2 years will begin to operate from the date on which the **Petition of Appeal is received** by the Board of Review and **not from the date of the oral hearing**. It is crystal clear that the issue before His Lordship Gooneratne J. was whether the legislature intended that the hearing used in the second proviso to section 140 (10) of the Inland Revenue Act, No. 38 of 2000 (as amended), for the calculation of a two-year time period commences from the **date of the oral hearing** as contended by the State or **from the date of the Petition of Appeal** received by the Board of Review as contended by Dr. Shivaji Felix. His Lordship Gooneratne J. answered this question at pp. 176-177 as follows:

"It is very unfortunate that it took almost 6 ½ years or more to reach its conclusion from the date of filing the Petition of Appeal in the Board. But the oral hearing commenced on 21.06.2006. This of course is well within the time limit and I would go to the extent to state that the Board has been very conscious of early disposal of the appeal. Board cannot be faulted for getting the appeal fixed for hearing as stated above since it is the duty and function of the Secretary of the Board to fix a date and time for hearing and to notify the parties. If it was the intention of the legislature that hearing should be concluded within 2 years from the date of filing the petition or that the time period of 2 years begins to run from the date of filing the petition, there could not have been a difficulty to make express provision, in that regard. I do agree with the view of the State Counsel. ***Hearing no doubt commences from the date of oral hearing. I would as such answer this question in favour of the Respondent and endorse the view of the Board of Review.*** *It is not time barred as the Board arrived at the determination within 2 years." [Emphasis added]*

[67] It is crystal clear that His Lordship Gooneratne J. flatly rejected the argument of Dr. Shivaji Felix that the legislature intended that the hearing should be concluded within 2 years **from the date of filing the petition of appeal** or **that the time period of 2 years begins to run from the date of filing the petition of appeal**. His Lordship Gooneratne J. was not prepared to be guided by the Budget Speech made by the Minister in charge of the subject and hold with the

Appellant that the legislative intention was that the hearing should be concluded within 2 years from the date of the filing of the petition of appeal.

[68] For those reasons, His Lordship Gooneratne J. having considered the question involved (Question No. 2) held with the Respondent on the basis that the hearing for the calculation of time limit of 2 years specified in section 140 (10) commences from the date of the oral hearing and not from the date of filing the petition of appeal. In my view, the principle laid down by Gooneratne J. in *Mohideen v. Commissioner General Inland Revenue* (supra) was that the hearing for the purpose of time limits of 2 years specified in the second proviso to Section 140 (10) of the Inland Revenue (Amendment) Act, No. 37 of 2003 commences from the date of the oral hearing and no more.

[69] That was the principle upon which the case was decided by His Lordship Gooneratne J. which represents the reason and spirit of the decision and that part alone is the principle which forms the only authoritative element of a precedent in *Mohideen v. Commissioner General Inland Revenue* (supra). Having laid down the principle upon which the case shall be determined on the Question of Law No. 2, His Lordship Gooneratne J. proceeded further to consider the facts of the case and found that the hearing commenced on 17.02.2006 and the determination was made by the Board on 21.06.2006 and therefore, the determination was made within the time limit specified in the said proviso. Thus, His Lordship answered the question No. 2 in favour of the Respondent in the following manner:

> "I would in answer to this question of law, hold that the Board has not erred by arriving at its determination the way it was done in this appeal" (p. 177).

[70] After having answered the Question of Law, No. 2 in favour of the Respondent and while fully endorsing the proposition of law that the hearing contemplated in the said time bar provision is nothing but oral hearing and thus, the time bar of 2 years ought to be calculated from the date of the oral hearing, His Lordship made some remarks with regard to the need of adopting a practical and meaningful interpretation to the day-to-day functions in a court of law and statutory bodies. His Lordship remarked that where specific time limits are to be laid down, the legislature has to say so in very clear, unambiguous terms instead of leaving it to be interpreted in various ways. Then, as a passing remark which was not the principle upon which the issue was answered in favour of the Respondent, Gooneratne J. says that *"It would be different or invalid if the time period exceeded 2 years from the date of oral hearing. If that be so, it is time barred". The relevant passage at page 176 reads as follows:*

"As such in the context of this case and by perusing the applicable provision, it seems to me that the hearing contemplated is nothing but 'oral hearing'. One has to give a practical and meaningful interpretation to the usual day to day functions or steps in a court of law or a statutory body involved in quasi-judicial functions, duty or obligation. If specific time limits are to be laid down, the legislature needs to say so in very clear, unambiguous terms instead of leaving it to be interpreted in various ways. To give a restricted interpretation would be to impose unnecessary sanctions on the Board of Review. ***It would be different or invalid if the time period exceeded 2 years from the date of oral hearing. If that be so, it is time barred."***

[71] Obviously, the last sentence of the passage was not the principle upon which the issue was finally decided in favour of the Respondent in *Mohidden v. Commissioner General Inland Revenue* (supra) that forms part of the reason and spirit of the decision as the authoritative element of the decision. The point in Question of Law No. 2 was decided against the Appellant who argued that the time limit of 2 years ought to be calculated from the date of the receipt of the Petition of Appeal by the Board and not from the date of oral hearing.

[72] That part of the statement enunciated by His Lordship Gooneratne J. that "it would be different or invalid if the time period exceeded 2 years from the date of oral hearing. If that be so, it is time barred" is a passing observation, in the form of an assumption or hypothesis unaccompanied by the principle upon which the case was decided in favour of the Respondent, is manifestly an obiter and not the ratio having a binding authority.

[73] On the other hand, His Lordship Gooneratne J. was never called upon to go into the factors, whether or not the second proviso to Section 140 (10) of the Inland Revenue Act could be regarded as mandatory or directory, having regard to the nature, purpose and the design of the statute, the consequences that may flow from non-compliance, if the act is not done within that period. So, those factors were not considered by His Lordship Gooneratne J. in *Mohideen v. Commissioner-General of Inland Revenue* (supra). Also not called upon and not considered are the factors such as whether or not the non-compliance is visited with some penalties, or the statute provides for a contingency of non-compliance of the time limit provision or any practical inconvenience and injustice to parties who have no control over those entrusted with a statutory duty and deprivation of their statutory rights at their no fault.

[74] In the light of the above discussion, I am of the opinion that, the portion of the statement of Gooneratne J. in question cannot have the character of a ratio

decidendi but a mere casual statement or observation or remark which does not form the part of the legal principle upon which the case was decided and thus, it has no authoritative value.

[75] For those reasons, I have no reasons to disagree with the decisions of Janak de Silva, J. in *Stafford Motor Company Limited v. The Commissioner General of Inland Revenue* (supra) and *Kegalle Plantations PLC v. Commissioner General of Inland Revenue* (supra). For those reasons, I am in agreement with the reasoning of His Lordship Janak de Silva J. in the above-mentioned decisions that the statement of His Lordship Gooneratne J. in *Mohideen v. Commissioner General of Inland Revenue* (supra) is obiter dicta statement and the time limit specified in section 10 is not intended to be mandatory.

[76] We took the same view in our judgments in *Mr. S.P. Muttiah v. The Commissioner General of Inland Revenue,*CA/TAX/46/2019,decided on 26.06.2021 and *Amadeus Lanka (Pvt) Ltd v. CGIR* (C.A Tax 4/19 decided on 30.07.2021. In *Mr. S.P. Muttiah v. The Commissioner General of Inland Revenue (supra)*, we further held that *"If we interpret the legislative intent of Section 10 from its mere phraseology, without considering the nature, purpose, the design, the absence of consequences of non-compliance and practical impossibility, which would follow from construing it one way or the other, it will tend to defeat the overall object, design, the purpose and spirit of the Tax Appeals Commission Act"* (pp77-78). We further held that the directory interpretation of section 10 is consistent with the object, purpose and design of the Tax Appeals Commission Act, which is reflected in the intention of the legislature. We held that if a gap is disclosed in the Legislature, the remedy lies is an amending Act, and not in a usurpation of the legislative function under the thin disguise of interpretation.

[77] For those reasons, I hold that the determination of the Tax Appeals Commission in the present case is not time barred and thus, I answer the Question of Law No. 1 in favour of the Respondent.

Questions of Law Nos. 2-9

[78] The questions of law, 2-9 are closely connected to each other and therefore, they will be dealt with together in this judgment. Mr. Nihal Fernando submitted that for the Appellant to fall within the charging section (s. 25A of the VAT Act), must satisfy two requirements, namely, (i) the Appellant should provide a financial service as defined in section 25F; and (ii) such financial service should be carried

on in the course of business of supplying financial services. His main arguments included: (i) the Appellant is neither a finance company nor a bank providing finance services within the meaning of the VAT Act; (ii) the Appellant is neither involved in the business of supplying financial services nor provided any of the financial services contemplated in section 25F of the VAT Act; (iii) the Appellant is only engaged in insurance business, and its life insurance business is highly statutorily regulated business under and in terms of the Regulation of Insurance Industry Act, No. 43 of 2000 (as amended); (iv) the life insurance business that comprises the investment of policy holders' premium income in securities and other similar instruments; (v) the life insurance is not a financial service within the contemplation of section 25F of the VAT and the life insurance is exempted from VAT in terms of item (x) (i) of Part II(b) of the First Schedule to the VAT Act; (vi) A portion of life insurance cannot be subject to VAT on financial services and the Appellant is not liable to pay VAT on financial services in respect of the interest income received from the investment of the policy holders' premium income in securities and other similar instruments.

[79] On the other hand, Mr. Milinda Gunetilleke, whilst conceding that life insurance aspect of the Appellant's business is exempt from VAT submitted that nevertheless, the interest income received by the Appellant from the activities identified by the assessor, falls within the meaning of the 'provision of loan, advance or credit' in section 25F(g) of the VAT Act. He further submitted that none of the activities identified by the assessor form part of the life insurance business, but part of investment income received from government securities and other similar instruments. His contention was that all interest income received from financial activities in question could be treated as supply of financial services falling within "loans, advance or credit" subject to VAT on financial services under section 25F of the VAT Act.

The issues before Court

[80] It is not in dispute that the Appellant is engaged in the insurance business carrying on both life and general insurance and that the general insurance business is subject to VAT. The main issues related to the questions of law in the case stated, which needed to be addressed by this Court were as follows:

1. (a) Whether the "life insurance" is a supply of financial service within the meaning of section 25F, in particular section 25F(g) of the VAT Act;

(b) Whether the Appellant could be held to be a person carrying on the business of supplying financial services under section 25A(2) read with section 25F of the VAT Act;

(c) Whether the "life insurance" is exempt from VAT in terms of item (i) Part II of the First Schedule to the VAT Act;

2. Whether the Appellant is prevented from engaging in the business of financial services in view of the regulatory framework in terms of the Regulation of Insurance Industry Act, No. 43 of 2000 without prior approval of the Insurance Board and if so, whether the Appellant carried on the business of supplying financial services within the meaning of section 25A(2) of the VAT Act;

3. (a) Whether the life insurance business involves an investment element and if so, whether the interest income received by the Appellant from investment in securities and other similar instruments is part of the life insurance business, which is exempt from VAT on financial services in terms of item (i) Part II of the First Schedule to the VAT Act;

(b) Whether the investments in question are ancillary or associated with the insurance business which can be classified as financial services and if so, whether such activities are an integral part of the business income of the Appellant;

(c) If so, whether for the purpose of VAT on financial services, the value addition attributable to investment income earned by investing in insurance premiums is considered a taxable supply of financial services as per section 25(C) of the VAT Act.

The applicable law

[81] The scope for the imposition of VAT is provided for in section 2 of the VAT Act. Section 2 of the VAT Act provides that, subject to the provisions of the VAT Act, the Value Added Tax (VAT) 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, or carrying out , of a **taxable activity** by such person in Sri Lanka;

(b) on the importation of goods into Sri Lanka, by any person,

and on the value of such goods or services supplied or the goods imported, as the case may be subject to the provision of section 2A, at the rates morefully specified in the said section.

[82] In terms of section 2 of the VAT Act, in order to render the relevant supply of goods and services liable to VAT, the said supply has to be a taxable supply of goods and services made by a registered person and made in the course of carrying out a taxable activity. The terms "supply of goods", "taxable supply" and "taxable activity" are defined in section 83 of the VAT Act.

VAT on Financial Services

[83] The case is, however, concerned about the imposition of VAT on the supply of financial services under Chapter IIIA of the VAT Act. To examine the argument of Mr. Nihal Fernando, that the life insurance business with an investment element is exempt from VAT on financial services, it is relevant to consider the statutory provisions of the VAT Act, and the categories of persons liable to pay VAT on financial services. The VAT on financial services is imposed as a direct tax, and the imposition of VAT on the supply of financial services by specified institutions was first introduced by the VAT (Amendment) Act, No. 7 of 2003 by inserting in section 25 of the VAT Act, a new subsection, 25A. Section 25A applied to the imposition of VAT on the supply of financial services initially by specified institutions. It reads as follows:

> *"(1) Notwithstanding the provisions of Chapter I, II, III and item (xi) of the First Schedule to this Act, a Value Added Tax (hereinafter in this Chapter referred to as "the Tax") shall be charged in accordance with the provisions of this Chapter with effect from January 1, 2003, on the supply of financial services in Sri Lanka, made by any specified institution which carries on a business of supplying such financial services".*

Categories of Persons liable to pay VAT on Financial Services

[84] Section 25A of the VAT Act was further amended by the VAT (Amendment) Act, No. 13 of 2004 by expanding the imposition of VAT on the supply of financial services by any person. Accordingly, the imposition of VAT on the supply of financial services applies to a specified institution and any person. Section 25A (1) of the VAT Act, No. 14 of 2002 as amended by the VAT (Amendment) Act. No. 13 of 2004 now reads as follows:

"25A(1) Notwithstanding the provisions of Chapter I, II, III and item (xi) of the First Schedule to this Act, a Value Added Tax (hereinafter in this Chapter referred to as "the Tax") shall be charged in accordance with the provisions of this Chapter on the supply of financial services in Sri Lanka-

*(i) by any **specified institution** during the period commencing January 1, 2003 and ending on June 30, 2003; and*

*(ii) by **any person** on or after July 1, 2003 but prior to December 31, 2007;*

(iii) by any person other than a Co-operative Society registered under the Co-operative Society Law, No. 5 of 1972, on or after January, 1, 2008 but prior to January, 2009; and

(iv) *by any person other than a **Co-operative Society** registered under the Co-operative Societies Law No. 5 of 1972 or **Lady Lochore Loan Fund** established under the Act No. 38 of 1951, commencing on or after January 1. 2009, or the **Central Bank** of Sri Lanka established by the Monetary Law Act (Chapter 422) (with effect from Julay 1, 2003).* [Emphasis Added].

Provided however, the supply of financial services by a Unit Trust or a Mutual Fund shall not be treated as a financial service for the purpose of this section.

[85] A person includes a company or a body of persons (Vide- section 83 of the vAT Act) and therefore, the Appellant is captured within the meaning of section 83 of the VAT Act for the purpose of section 25A(1)(ii). It is manifest that for the time period relevant to this case, and subject to the aforesaid three exceptions, and other specific exemptions, all persons including any specified institution and any person are liable to pay VAT on financial services.

Is the Appellant a specified institution?

[86] Now, the first question is whether or not, the Appellant is a "specified institution" who carries on the business of supplying financial services within the meaning of Section 25F of the VAT Act, to be liable to pay VAT on financial services. Section 25F defines a "specified institution" which includes a finance company registered under the Finance Companies Act, No. 78 of 1988. In terms of Section 25F, a "specified institution" broadly means-

(a) a licensed commercial bank within the meaning of the Banking Act, No. 30 of 1988;

(b) a finance company registered under the Finance Companies Act, No. 78 of 1988;

(c) a licensed specialized bank within the meaning of the Banking Act, No. 30 of 1988.

[87] It is not in dispute that the Appellant is not a licensed commercial bank or a finance company or a licensed specialized bank within the meaning of section 25F of the VAT Act. Admittedly, the Appellant is an insurance company engaged in general and life insurance business within the meaning of the Regulation of Insurance Industry Act, No. 43 of 2000 (as amended). Mr. Gunatilleke however, argued that the Appellant is still a "person" carrying on the business of supplying financial services within the meaning of section 25F(g) of the VAT Act and, therefore, the Appellant is liable to pay VAT on financial services within the meaning of section 25A(1) of the VAT Act. The next question is to decide whether the Appellant is still a "person carrying on the business of supplying financial services" and therefore, the Appellant is liable to pay VAT on financial services within the meaning of section 25A(1) of the VAT Act.

[88] To make the Appellant liable to pay VAT on financial services, under the second head of the charging section, viz, section 25A(1)(ii), it must be satisfied that the Appellant is "a person who is carrying on the business of supplying financial services". The second head was introduced by the VAT (Amendment) Act No. 13 of 2004 and the relevant portion of section 25A(1) after the amendment in 2004 section 25A(1) reads as follows:

"on the supply of financial services in Sri Lanka-

(i) by any specified institution during the period commencing January 1, 2003 and ending on June 30, 2003; and

(ii) by any person on or after July 1, 2003,

where such specified institution or person carries on the business of supplying such financial services*".*

[89] Section 25G of the VAT Act was also introduced by the VAT (Amendment) Act, No. 13 of 2004, which applies to the periods of assessment in this case, and thus, any person should carry on the business of supplying financial services, which reads as follows:

*"Where **any person carries on the business of supplying financial services, the** preceding provisions of this Chapter, shall mutatis mutandis apply, to and in relation to the supply of such services made by such person on or after July 1,2003".*

[90] It is relevant to note that section 25A(2) of the VAT (Amendment) Act further provides that the VAT on financial services applies to any specified institution or a person carrying on the business of financial services. It reads as follows:

*"25A(2). Every specified institution or **other person, carrying on the business of supplying of any financial services in Sri Lanka,** shall be required to be registered .....*

[91] The twofold elements to be satisfied for the imposition of VAT on the supply of financial services by specilised Institutions or by any person under Chapter IIIA of the VAT Act are the following:

1. The Appellant supplied/provided a financial service as defined under section 25F of the VAT Act; and
2. Such financial service was supplied in the course of the business of supplying financial services.

Is the Appellant a person "carrying on the business of supplying financial services" within the meaning of section 25A(1)(ii) of the VAT Act.

VAT on Supply of Financial Services

[92] The next point is to consider whether the income assessed by the assessor falls within the definition of "supply of financial services" and if not, whether it is outside the ambit of the VAT on Financial Services. Based on the audited statement of accounts of the Appellant for the year 2011/2012 has identified the following net profits as supply of financial services under section 25F:

1. Interest income on repurchase of Treasury Bills;
2. Interest income on repurchase of Treasury Bonds;
3. Interest income on Treasury Bills;
4. Interest income on Bonds;
5. Interest income on Debentures;
6. Interest income on Unquoted debentures;
7. Interest income on policy loans;

8. Penalty Interest income on insurance Housing Loans;
9. Interest on insurance Housing Loans;
10. Interest on Raksana Sevana;
11. Penalty Interest insurance on Raksana Sevana;
12. Interest income on Loans to Field Staff;
13. Interest income on on Loans to Office Staff;
14. Interest earned on Sri Lanka Development Bonds;
15. Unrealized Gain on Foreign Currency Conversions.

[93] Now the question is whether the interest income received by the Appellant from those activities is for the supply of financial services and if so, whether such income was received by the Appellant while "carrying on the business of supplying financial services". Mr. Nihal Fernando conceded that the insurance business constitutes a financial service, but it is not a financial service within the meaning of section 25F of the VAT Act as set out in Chapter IIIA of the VAT Act. [95] Section 25F of the VAT Act exclusively defines the transactions or activities that fall within the meaning of "supply of financial services". It reads as follows:

"25F. For the purposes of this Chapter-

supply of financial services means-

(a) the operation of any current, deposit or savings account;
(b) the exchange of currency;
(c) the issue, payment, collection or transfer of ownership of any note, order for payment, cheque or letter of credit ;
(d) the issue, allotment, transfer of ownership, drawing, acceptance, or endorsement of any debt, security, being any interest in or right to be paid money owing by any person other than the transfer of nonperforming loans of a licensed Commercial Bank to any other person in terms of a re-structuring scheme of such bank as approved by the Central Bank of Sri Lanka with the concurrence of the Minister;
(e) the issue, allotment, transfer of ownership of any equity security or a participatory security;
(f) issue, underwriting, sub-underwriting or subscribing of any equity security, debt security or participatory security;
(g) the provision of any loan, advance or credit;
(h) the provision-

(a) of the facility of instalment credit finance in a hire purchase conditional sale or credit sale agreement for which facility a separate charge is made and disclosed to the person to whom the supply is made;

(b) goods under any hire purchase agreement or conditional sale or hire purchase agreement while have been used in Sri Lanka for a period not less than twelve months as at the date of such agreement".

[94] The TAC referring to section 25F of the VAT Act states that the investments made by the Appellant in Treasury Bills, Bonds, Housing loans, and other securities are integral part of the financial business of the Appellant and thus, the interest income received by the Appellant from such investments could be treated as a business income of the Appellant. The relevant findings of the TAC at page 7 of the TAC brief are as follows:

> *"As submitted by the Representative for the Respondent, it is to be noted that whether the investment income to be treated as a business income will depend on the nature of the business. If the nature of the business is such that making of investment is an integral part of the business, so as to establish a strong link between the investment and liabilities to be met, it is possible to conclude that interest income earned from such investments could comprise of the business income. When a bank or an insurance company make investments to receive interest, such interest income could be used to meet the commitments of their customers. In this case, the magnitude of the amount received by the SLIC as interest income, will no doubt that it could be treated as a business income*".

[95] The TAC appears to have made the decision from the income tax perspective without paying attention to the exemption of life insurance from VAT in section 25F, and the relationship between the life insurance business and the investment component of the life insurance business. The TAC however, did not proceed to consider whether such income was received by the Appellant while engaging in the business of supplying financial services as required by section 25A(1)(ii) of the VAT Act.

Exemption of life insurance from VAT

[96] Now, I desire to consider the question whether the life insurance business is specifically excluded from the supply of financial services as defined in section 25F of the VAT Act. Mr. Nihal Fernando, submitted that in terms of item (x) (i) of Part II (b) of the First Schedule to the VAT Act, life insurance was specifically excluded and when VAT on financial services was introduced, the legislature deliberately

reproduced all items from item (a) to (h) of (x) of Part II(b) of the First Schedule. He submitted, however, that the legislature deliberately left them out and did not reproduce the item (i) of (x) of Part II (b) of the First Schedule, namely the life insurance. His contention was that the legislature did not intend to define life insurance business as part of supply of financial services under section 25F of the VAT Act.

[97] Mr. Gunetilleke, however, argued that after the VAT on financial services was introduced by the VAT (Amendment) Act, No. 7 of 2003 and further amended by the subsequent VAT (Amendment) Act, No. 13 of 2004, VAT on financial services applied "notwithstanding" the provisions of Chapters I, II and III and item (xi) of the First Schedule. He argued that what was taxable as "financial services" under Chapter IIIA of the VAT Act is not defined in section 25F of the VAT Act and, therefore, the activities in subparagraphs (a) to (g) are taxable as financial services, notwithstanding the fact that these same items appear under item (xi) in Part I of Schedule 1. In view of Mr. Gunetilleke's submission that VAT on financial services applied to the Appellant "notwithstanding the provisions of Chapters I, II, III and item (xi) of the First Schedule, it is necessary to consider whether the exemption for life insurance set out in item (x) (i) of **Part II(b)** of the First Schedule is inapplicable to life insurance.

[98] Section 8 of the VAT Act provides that the supply of goods and services in the First Schedule to the VAT Act are not taxable unless zero rated under section 7. Prior to the introduction of the VAT on financial services, item (xi) (i) of the First Schedule to the VAT Act, No. 14 of 2002 excluded life insurance, "Agrahara" Insurance and crop and livestock insurance" from VAT. VAT on financial services was however, introduced by the VAT (Amendment) Act, No. 7 of 2003 (See Chapter IIIA and section 25A of the VAT Act (as amended). By the VAT (Amendment) Act, the First Schedule was divided into two Parts that dealt with the commencement and ending of the two taxable periods. Item (xi) Part I of the First Schedule to the VAT Act deals with taxable periods commencing from on or after August 1,2002 and ending prior to January 2004, and item (xi) of Part II of the First Schedule deals with taxable periods commencing on or after January 1, 2004. (See VAT (Amendment) Act, No. 13 of 2004). The relevant taxable periods in the present case are from January 2011 to December 2011 and hence, it is **Part II** of the First Schedule that applies to this case.

[99] Item (x) (i) of Part II (b) of the First Schedule to the VAT Act, (as amended) specifically exempts, *inter alia*, the "**life insurance"** from VAT liability. The relevant part of the First Schedule to the VAT Act reads as follows:

"PART II

For any taxable period commencing on or after January 1, 2004-

(a)…
(b) The supply of …..
(x)…..

(i) the life insurance, "Agrahara" insurance and crop and livestock insurance".

[100] It is crystal clear that VAT on financial services is not specifically enumerated in section 25F of the VAT Act as an item of financial services so as to constitute a chargeable financial service. If the legislature intended to exclude life insurance of VAT in the First Schedule to the VAT Act, it was unnecessary for the legislature to amend the First Schedule by VAT (Amendment) Act, No. 13 of 2004 and exempt VAT from the supply of life insurance in item (x) (i) of Part II(b) of the First Schedule to the VAT Act.

[101] A perusal of item (x) of Part II(b) of the First Schedule reveals that the legislature deliberately reproduced all items from item (a) to (h) of item (x) of Part II(b) of the First Schedule in section 25F of the VAT Act as transactions of financial services, but deliberately omitted **life insurance**, "**Agrahara" Insurance and crop and livestock insurance** in section 25F of the VAT Act as financial services. On the other hand, if the legislature in introducing VAT on financial services intended to subject life insurance transaction to VAT on financial services, it could have easily defined "**life insurance**" as a financial service in section 25F of the VAT Act. It is relevant to note that section 25F of the VAT Act exhaustively defines "supply of financial services". It states "For the purposes of this Chapter (Chapter IIIA) which relates to VAT on financial services "supply of financial services **means** and defines an exhaustive list of financial services. However, the "**life insurance, "Agrahara" Insurance and crop and livestock insurance**" were deliberately omitted from section 25F as financial services chargeable with VAT.

[102 In regard to the interpretation of the word "means", it is apposite to refer to P.M.Bakshi on Interpretation of Statutes, First Edition, , Reprint 2011, which at p. 242 states:

"Generally, when the definition of a word begins with "means" it is indicative of the fact that the meaning of the word has been restricted: that is to say, it would not mean anything else but what has been indicated in the definition else……Therefore, unless there is any vagueness or ambiguity, no occasion will arise to interpret the term in a manner which may add something to the meaning of the word, which ordinarily does not mean by the definition itself, more particularly, where it is a restrictive definition" (see-further Feroze N. Detiwala v. P.M. Wadhwani (2003) 1 SCC 433).

[103] In the Indian case of *Mutto v. T.K. Nandi,* [1979] 2 SCR 409 (418), it was said: "*The Court has to determine the intention as expressed by the words used. If the words of a statute are themselves precise and unambiguous, then no more can be necessary than to expound those words in their ordinary and natural sense. The words themselves alone do in such a case best declare the intention of the lawgiver.*" As it was stated in another Indian case of *Thompson v. Gould*, [1910] A.C. 409 (420) "*it is a wrong thing to read into an Act of Parliament words which are not there, and in the absence of clear necessity, it is a wrong thing to do so.* The cardinal rule of construction of statute is to read statutes literally, that is, by giving to the words their ordinary, natural and grammatical meaning." [*Jugalki- shore v. Ram Cotton Co. Ltd.*, [1955] 1 SCR 1369]. In *Punjab Land Development and Reclamation Corporation Ltd v. Presiding Officer, Labour Court, Chandigarh* (1990) 3 SCR 111), the Supreme Court of India stated:

"The definition has used the word 'means'. When a statute says that a word or phrase shall "mean"--not merely that it shall "include"--certain things or acts, "the definition is a hard-and-fast definition, and no other meaning can be assigned to the expression than is put down in definition" (per Esher, M.R., Gough v. Gough, [1891] 2 QB 665). A definition is an explicit statement of the full connotation of a term".

[104] During the course of argument, Mr. Gunetilleke conceded that life insurance is exempt from VAT and the same is stated in paragraphs 49 and 50 of the written submissions filed on behalf of the Respondent on 21.02.2013 as follows:

"49.However, life insurance which is subparagraph (h) (i) under item (xi) of Part I schedule 1, is not listed in section 25F of the VAT Act.

50.Accordinglu, even after the enactment of Chapter III of the VAT Act, life insurance remains exempt from VAT".

[105] In my view, insurance business other than the following is liable to VAT:

1. **Life insurance;**

2. Agrahara Insurance; and
3. Crop and livestock insurance.

[106] I am also of the view that life insurance is not specifically enumerated in section 25F of the VAT Act as a "supply of financial services" (see- section 25F). As regards the question of law No. 3, Mr. Nihal Fernando submitted that the TAC has failed to consider that in calculating the tax under section 25C(5)(c) of the VAT Act, the profits arising from the business of life insurance are exempt supplies under item (x) of paragraph (b) of Part II of the First Schedule, and thus, they shall be regarded as zero rated under section 25 (C(5). Section 25C (5) provides:

"(5) For the purpose of calculating the tax, the value addition attributable to-

a. except supplies, other than the exempt supplies under item (x) of paragraph (b) of Part II of the First Schedue but taxable under this Chapter;
b. zero rated supplies;
c. taxable supplies on which tax has been paid or is payable in terms of this Act, other than the value addition in relation to supplies taxable under Chapter;……

included in the profits calculated as specified in subsection (1) of this section shall be treated as zero rated".

[107] As noted, the business of life insurance, "Agrahara" insurance and crop and livestock insurance is exempted from VAT within the meaning of item (x) of paragraph (h) of Part II of the Firrt Schedule to the VAT Act. It is not a "supply of financial service" within the meaning of section 25Fof the VAT Act.

Whether investments in securities and other financial instruments fall within the phrase "loan, advance or credit in section 25F(g) of the VAT Act

[108] Mr. Gunetilleke however, submitted that while life insurance is excluded from VAT, the VAT on financial services is calculated having separated the premium income received from the Appellant's life insurance business which is VAT exempt. He submitted that the activities in question relate to investment income of the Appellant, which fall within "loans, advance or credit" in section 25F, which is chargeable with VAT. He argued that the activities set out in subparagraphs (a)-(g) of section 25F are taxable as financial services, notwithstanding the fact that life insurance is not listed in section 25F of the VAT Act. It was the contention of Mr.

Gunetilleke that **certain activities** of the Appellant's business, namely, the activities in subparagraph 25F(g)-"the provision of any loan , advance and credit" falls within the definition of financial services in terms of section 25F of the VAT Act. He submitted that none of the fifteen activities identified by the assessor is life or general insurance business, but are investment income falling within "loan, advance and credit" in section 25F(g) of the VAT Act.

[109] He strongly relied on the Registered Stocks and Securities Ordinance, No. 7 of 1937 (as amended) and submitted that when the Government issued securities, it is raising a loan and thus, any person who purchases such securities issued by the Government is providing a loan to the Government. His submission was that, in addition to investment of life insurance business in government securities, the Appellant was also involved in the provision of interest bearing loan, advance and credit using other investments which are also liable to VAT on financial services. Mr. Gunetilleke, thus submitted that, therefore, the Appellant is liable for VAT on financial services under Chapter IIIA of the VAT Act.

Provision of Loan, advance or credit

[110] It is not in dispute that the provision of loan, advance or credit constitutes financial services as defined in section 25F of the VAT Act. The provision of any loan, advance or credit is wide enough to encompass activities such as- (a) loan facilities (that include the granting of credit or secured or unsecured credit facilities, the receipt of fees received in respect of such services, charges for making arrangement for the granting of credit; (b) provision of credit facilities that include purchase or repurchase arrangements and credit of the investments in stocks, investments or business purposes.

[111] It is not in dispute that Treasury bills are short-term debt instruments issued under the Local Treasury Bills Ordinance No. 8 of 1923 (as amended) and Treasury Bonds which are medium to long term debt instruments issued under the Registered Stock and Securities Ordinance, No. 7 of 1937 (as amended). It is not in dispute that Treasury Bonds and Treasury Bills are government debt securities issued by the Government of Sri Lanka and they earn periodic interest until maturity. Mr. Gunetilleke submitted that none of the above mentioned activities are part of the life insurance or general insurance business of the Appellant, but they form part of the separate investment income of the Appellant that fall within "loans, advance or credit" in section 25F (g) of the VAT Act. He, apparently, sought to restrict the life insurance to the "pure premium income"

received from the policy holders and treat the interest component of life insurance received from the investment of premium income as a "separate investment business" for the purpose of imposing VAT on financial services.

[112] Mr. Nihal Fernando however, submitted that the insurance business is a highly regulated business and the life insurance business consists of a number of activities. He submitted that the lise insurance includes: (a) the acceptance of a premium; (b) creating a life insurance fund and making investments using the said fund in accordance with applicable regulations; (c) meeting the management expenses; (d) payment of bonuses and ultimately paying the policy holders upon maturity and/or occurrence of a covered incident. He further submitted that in life insurance business, when the premium is received, it is accounted for as a liability and not an income and the said premium goes into a life insurance fund which has to be returned to the policy holder upon maturity of the policy with bonuses or on the occurrence of an event covered by the policy. His contention was that the life insurance business is not merely to accept a premium and to return after the policy maturity or on the occurrence of an insured incident as it is a highly regulated business. His contention was that a premium which is received by the Appellant in life insurance is not consumed during the year like in the case of general insurance but becomes accumulated in a fund.

[113] The determination of this aspect of the case is limited to the question whether the interest income received by the Appellant is tied to the life insurance fund with an investment element, or it was received from a separate investment business, which is unrelated to the policy holders' monies included in the life insurance fund. In this context, it is necessary to look at the nature of the life insurance contract and its investment portfolios in carrying on the insurance business. Though the supply of services relating to life insurance contracts by the insurers is exempt from the liability of VAT, there is no definition in the VAT Act as to what activities of business that constitute the business of life insurance and the business of insurance other than life insurance business (S.Balaratnnam, VALUE ADDED TAX IN SRI LANKA, p. 605).

What is Insurance Business?

[114] I desire to first consider the meaning of life insurance business and the regulation of the life insurance business as set out in the Regulation of Insurance Industry Act, No. 43 of 2000 as amended by the Regulation of Insurance Industry (Amendment) Act, No. 27 of 2007 & Act, No. 03 OF 2011. The classes of insurance

business are defined in section 114(1) of the said Act. The classification begins with the broad division between "long term business" (i.e. life insurance and certain related classes to which the Act applies), and "general business" (i.e. the classes which are described as "non-life" to which the Act applies). Section 114 of the Regulation of Insurance Industry Act (as amended) defines the phrase "insurance business" broadly and provides the following definition of both life insurance and general insurance business:

114(1) ***"insurance business****" means –*

(a) long term insurance business, that is to say, the business of entering into or maintaining contracts of assurance on human lives, such contracts including contracts whereby the payment of money is assured on death or on the happening of any contingency dependent on human life, and contracts which are subject to payment of premia for a term dependent on human life, and such contracts being deemed to comprise and include the following sub-classes :-

(i) ***life insurance – contracts of insurance dependent on human life ;***
(ii) linked long term – where benefits are wholly or partially determined by reference to an index or to the value of or to the income from assets of any description ;
(iii) annuities – contracts for the grant of annuities dependent on human life ;
(iv) contracts for the granting of disability and multiple indemnity, accident and sickness benefits if so specified in such contracts, but excluding insurance business which is principally or wholly of any kind included in sub paragraph (i), (ii), (iii), (v) and (vi) ;
(v) permanent health – contracts of insurance providing specified benefits on incapacity from accident or sickness which are both in effect for a period of more than five years and cannot be cancelled by the insurer ;
(vi) capital redemption contracts ; and
(vii) pension policies– insurance contracts to provide pre and post retirement benefits for individuals.

(b) General Insurance Business which means all insurance business which do not fall within the definition of "long term business" being deemed to comprise and include the following sub classes :-

(i)"marine, aviation or transit insurance policy" means a policy of insurance …

(ii) fire insurance business, that is to say, the business of effecting, otherwise than incidentally to some other class of insurance business, contracts of insurance against loss by, or incidental to, fire or other occurrence customarily included among the risks insured against in fire insurance policies;

(iii)motor vehicle insurance business, that is to say, the business of effecting contracts of insurance against loss of motor vehicles or damage arising out of or in connection with the use of motor vehicles, including third-party risks;

(iv)employers' liability insurance business, that is to say, the issue of, or the undertaking of liability under policies insuring employers against liability to pay compensation or damages to workmen in their employment;

(v)miscellaneous insurance business, including personal accident insurance, fidelity guarantee insurance, burglary insurance, cash in transit insurance, cash in safe insurance, contractors all-risk insurance, erection all-risk insurance, electronic/computer insurance, boiler insurance and machinery breakdown insurance but excluding insurance business which is principally or wholly of any kind or kinds included in sub-paragraphs (i), (ii), (iii) and (iv) and those classes which would fall within the definition of "long term business" involving contracts of a long-term nature.

[115] An insurance contract is one whereby one party (the insurer) promises in return for a money consideration (the premium) to pay to the other party (the assured) a sum of money or to provide him with a corresponding benefit upon the occurrence of one or more specified events (MaCGILIVRAY ON INSURANCE LAW, 12th Ed. P. 3). The characteristics of a contract of insurance are (i) premium; (ii) promise to pay; (iii) sum of money or corresponding benefit, which includes the provision of services to be paid for by the insurer for the benefit of the assured; and (iv) upon a special event involving uncertainty (Supra- pp 4-5). The essentials of an insurance transaction were explained in the CJEU *Proceedings brought by Försäkringsaktiebolaget Skandia (publ) (No 2) (C-240/99) EU:C:2001:140; [2001] 1 WLR 1617; [2001] ECR I-1951* paragraph 17 as follows:

"the essentials of an insurance transaction are, as generally understood, that the insurer undertakes, in return for prior payment of a premium, to provide the insured, in the event of materialisation of the risk covered, with the service agreed when the contract was concluded." (Proceedings brought by Försäkringsaktiebolaget Skandia (publ) (No 2) (C-240/99) EU:C:2001:140; [2001] 1 WLR 1617; [2001] ECR I-1951 paragraph 17)".

[116] In the case of *Prudential Insurance Co v IRC* [1904] 2 KB 658, Channell J. at paragraph 44 identified the key features of an insurance contract as (Prudential test):

1. a contract whereby, for some consideration, the insured secures some benefit, usually but not necessarily, the payment of money, upon the happening of

some event. It must be a contract for the payment of a sum of money or for some corresponding benefit;

2. the event must involve some amount of uncertainty, either that the event will ever happen or at the time at which it will happen;
3. the event must be adverse to the interest of the insured, such that the payment meets some loss or other detriment on the happening of the event i.e. there must be an insurable interest in the subject matter (otherwise the contract is one of wager);
4. in the case of life insurance, the interest is not the measure of loss.

What is life insurance?

[117] Life insurance is a contract whereby the insured agrees to pay certain sums, called premiums, at specified times, and in consideration thereof the insurer agrees to pay certain sums of money upon the death of the injured on certain conditions and in specified ways (*Life Insurance Corporation of India v. Vishwanath Verma and Ors*. (30.09.1994 - SC) : Civil Appeal No. 6493 of 1994, Decided on: 30.09.1994). In terms of section 114(1) of the Regulation of Insurance Act of 2004, 'Life Insurance' is confined to *"**contracts of insurance dependent on human life"*** and thus, the exemption of the life insurance applies to the insurer, being the person authorized to carry on such life insurance business (S.Balaratnnam, VALUE ADDED TAX IN SRI LANKA, p. 606). Life insurance contracts are relatively long-term compared to non-life insurance policies, which are usually for a short period of time. Life insurance involves one event– death, the risk of which for any individual is often based on a standard mortality table. In fact, to a large degree much life insurance is investment, and it remains, from a market point of view at least, an investment (Malcolm A. Clarke, The Law of Insurance Contracts, 5th Ed. P 16). What distinguishes it from other kinds of investment is that the gain or yield, depends on the contingencies of human life (Supra). Any activity which involves the investment of the customers' premiums, carry an element of risk for the insurer of the life insurance product or which can properly be seen as an insurance risk (Supra). Such an operation might be regarded as an activity which is related to the maintenance and preservation of life insurance fund and payment to the customers by way of bonuses and other corresponding benefits to the insurer.

[118] The insurer to carry on business requires authorization under the Regulation of Insurance Industry Act, No. 43 of 2000, and therefore, it is only the insurer effecting life insurance, who is exempt under the provisions in the VAT Act (S.

Balaratnnam, VALUE ADDED TAX IN SRI LANKA, p. 606). Now the question is whether the regulatory framework provided in the Regulation of Insurance Industry Act, No. 43 of 2000 prevents the Appellant from carrying on the business of financial services defined in section 25A(1)(ii) of the VAT Act.

Regulatory Framework and Insurance Fund

[119] I desire now to examine the Appellant's argument *vied* the regulatory regime established by the Regulation of Insurance Industry Act does not permit the life insurance company to engage in finance business, and therefore, the Appellant's life insurance business is distinct from the business of carrying on the supply of finance services. Mr. Nihal Fernando strongly relied on the provisions of the Regulation of Insurance Industry Act, No. 43 of 2000 and argued that the insurance business is a separate and distinct business which prohibits a life insurance company to engage in the finance business unless approval is obtained from the Insurance Board. He further submitted that there is no material whatsoever, that the Appellant was involved in other business activities and therefore, the entire interest income of the Appellant should be treated as having received from the life insurance business.

[120] Section 12 of the Regulation of Insurance Industry Act provides that no person shall carry on insurance business in Sri Lanka unless such person has registered under the Act and that no registered person shall carry on any form of business other than insurance business unless such person is permitted to carry on financial services business. Section 12 provides:

> *"12. (1) Subject to the provisions of this Act, from and after the appointed date, no person shall carry on insurance business in Sri Lanka unless such person is for the time being registered or deemed to be registered under this Act to carry on such business*
>
> .....
>
> *(2) A registration under subsection (1) may be for general insurance business or for long term insurance business*
>
> .....
>
> *(4) A person registered under subsection (1) shall not carry on any form of business other than insurance business:*
>
> *Provided that, a person may, with the prior written approval of the Board, carry on any financial services business which is ancillary or associated with the insurance business for which a registration is obtained under this Act".*

The insurance fund & compulsory investment in Government Securities

[121] The Appellant's argument also relies on section 25 of the Regulation of Insurance Industry Act which provides for the establishment by an insurer of separate insurance fund for each class of its insurance business, which stipulates what must be paid into an insurance fund and the restrictions on what an insurance fund may be used for. It is common ground that the Appellant was statutorily required to invest 20% of its assets from general insurance business and 30% of the assets from its life insurance business in terms of the Regulation of Insurance Industry Act. Sub-section (1) and (2) of section 25 of the Act reads as follows:

> *"25(1) Not less than twenty per centum of the assets of the technical reserve being maintained for a general insurance business under section 24 and not less than thirty per centum of the assets for the long term insurance fund being maintained under subsection (1) of section 38, shall be in the form of Government Securities. The balance assets shall be in the form of such other investments as shall be determined by the Board.*
>
> *25(2). The Board shall have the power, where it considers any investment of any assets in any reserve or fund referred to in subsection (1) of this section is unsuitable, to issue directions for the disposal of such investment within such time as may be specified in such directions".*

[122] It is crystal clear that only 20% of the general insurance and 30% of life insurance assets shall be invested in the form of government securities. The balance assets however shall be in the form of such other investments as shall be determined by the Board. Mr. Fernando further relied on section 27 which provides that the insurer shall separate its insurance business and maintain separate accounts in respect of each classs of insurance business. Section 27 provides:

> *"27. Where an insurer carries on business of one or more classes of insurance business, such insurer shall keep separate accounts of all receipts and payments in respect of each class of insurance business and also maintain separate accounts in respect of each sub-class of general insurance business it is carrying on".*

Solvency margin.

[123] Section 26 prescribed by the Act is another regulatory measure to ensure that the interests of policy holders are adequately protected. It reads:

"26. (1) Every insurer shall maintain in respect of each class of insurance business, a solvency margin of such amount as may be determined by the Board in respect of that class of insurance business, by rules made in that behalf. (2) Rules may be made by the Board to provide for the determination of the value of the assets and their admissibility and the amount of the liabilities for the purpose of determining the solvency margin to be maintained in respect of the class of insurance business being carried on by any such insurer. (3) For the purpose of ensuring the avoidance of mismatching of assets as against liabilities by insurers, the Board may, from time to time by rules made in that behalf, lay down criteria to be made applicable in determining the minimum limits of their assets as against their liabilities".

[124] Mr. Fernando's submission was that in view of the regulatory framework set out in the Regulation of Insurance Industry Act, the Appellant's interest income shall be treated as having received from all activities set out in the asessor's letter which would invariably be integral part of the life insurance business included in the life insurance fund. The reserve fund or the life insurance fund is merely part of the regulatory framework for insurance companies, but they cannot be determinative of its tax treatment of an insurance company. The imposition of the tax is solely within the purview of Parliament through the enactment of tax legislations, which must be interpreted by the Courts or relevant tribunals using principles developed by case law (*Comptroller of Income Tax v. BBO* (2014) SGCA) 10, paragraphs 44-45). In this case, Andrew Ang J. stated at pp 45-36:

"The insurance fund is merely part of the regulatory framework for insurance companies and cannot be determinative of their tax treatment. The imposition of tax is solely within the purview of Parliament through the enactment of clear tax legislation which is to be interpreted by the court or relevant tribunal using principles developed incrementally by case law. The fact that certain gains are attributable to investments held in statutorily mandated insurance funds cannot automatically *divest the relevant tribunal of its proper role in deciding whether, in all the circumstances of the case, the gains are properly attributable to the revenue or capital account. Otherwise, any regulatory body would theoretically be able to determine the taxation of companies. This runs counter to the fact that regulatory frameworks are often shaped by intricate policy considerations which may have little or nothing to do with tax.*

Moreover, the distinction between the insurance fund and the shareholders' fund, whilst relevant, cannot be determinative *of the tax treatment of particular assets or investments. Clearly, gains arising from the shareholders' fund could be taxed as income as well. In our judgment, insurance companies (whether holding assets in the insurance fund or shareholders' fund) should only be taxed according to the*

ordinary principles of revenue law, albeit the holding of an asset in a particular fund may be a relevant factor *in ascertaining whether the investment was intended to be held as a capital asset".*

[125] In my view, the purpose of the Regulation of Insurance Industry Act is for the regulation of the insurance business for the protection of policy holders' deposits in investments and the prohibition of insurance companies from engaging in financial services without authorization. The VAT liability of an insurance company is solely determined by the provisions of the Constitution through the VAT Act which is interpreted by the Courts and relevant tribunals. Now the question is to consider the relationship between the insurance business and the investment income derived from the policyholders' premium income in the life insurance fund and the relevant VAT liability arising therefrom. It is necessary to consider whether the investment activities carried out by the Appellant were required to earn income for the purpose of carrying on its insurance business and if so, whether the activities carried out by the insurance must be held to be a part of the life insurance business.

The role of investment income in the life insurance business- the Investment is part of the life insurance

[126] The crucial question is whether the interest income was a mere enhancement of value of the premium income of the life insurance fund from investment by realizing securities and other financial instruments. If not, the question is whether it was made in the course of carrying on the business of supplying of the financial services for sole profit-making defined in section 25F(g). In determining the scope of VAT, it is therefore necessary to draw a distinction between the life insurance business with an investment element, and investment business. Usually, insurance companies generate income from charging premiums in exchange for insurance coverage, and then invest them in other income-generating assets. There are two significant elements arising from the life insurance transaction, and the ultimate beneficial interest to the end customer. The first is the "insurance transactions proper" and the second is the **"**operations arising directly therefrom involving the element of investment". The insurance law allows insurance companies to carry out "not only insurance transactions proper" but also "operations arising directly therefrom" by investing the policy holders' monies in securities and other similar instruments for the purpose of earning an income.

[127] The Argument of Mr. Gunetilleke that the exemption of life insurance is limited to the minimum amount of "pure insurance premium" or the "amount of cash surrender value" in a "life insurance" contract does not exist in the modern investment oriented insurance business, which involves a combination of insurance premium component and investment component. It is to be noted that the obligation undertaken by the insurer under a contract of life insurance is not limited to the payment of monies to the policy holders upon maturity and/or on the occurrence of a covered event, as formerly thought, but it also extended to corresponding benefits or services offered to the insured by competitive life insurance companies such as bonuses, loans and other promotional benefits etc.

[128] Life insurance products generally perform the dual functions of the collection of premiums and depositing them in life insurance fund and investing them in an interest bearing financial assets. The investment of policy holders' monies in financial assets generates an additional interest income to the life insurance fund while the company waits for possible payouts. The life insurance is highly investment oriented business involving the insurance and investment component and the amounts invested from the insurance fund are tied to and payable to the policy holders, in addition to corresponding benefits in terms of the insurance contract. In *Calcutta Insurance Ltd. v. Commr. of Income Tax* AIR 1953 Cal, the Calcutta High court stated:

> *22. ..... A life insurance company must be prepared to pay claims under the policies issued by it, as and when they mature, and for that purpose must provide itself with sufficient funds. The premia received can never be sufficient and, therefore, the funds require to be augmented by investments which will bring in interest or dividends or may result in profit, if disposed of. The investments may appreciate or depreciate or may become unrealisable wholly or in part or their realisation may result in gain or loss.*

[129] A life insurance company can however, hold many other assets including the shareholders' fund which are unrelated to the life insurance contract, and the income derived from investing other assets in financial assets can only be categorized as income from investment business, which is not related to life insurance contract between the insurer and the policy holder. No doubt, a life insurance company makes profits or losses from investing monies in its life insurance fund, but it is an incident of an insurance business to receive premium in advance, and such invest them in financial assets to generate more income. The dividing line is whether the investment of premium income is merely an enhancement of the value of the premium income by investment, or was it done

while carrying on the business of supplying of financial services defined in section 25F (g).

[130] The appropriate approach in such situations was considered in relation to income tax, by the Lord Justice Clerk in the seminal case of *Californian Copper Syndicate (Limited and Reduced) v. Harris (Surveyor of Taxes)* (1904) 5 TC 159 ("*Californian Copper Syndicate*") at 165 to 166:

> *"It is quite a well settled principle in dealing with questions of assessment of Income Tax, that where the owner of an ordinary investment chooses to realise it, and obtains a greater price for it than he originally acquired it at, the enhanced price is not profit … assessable to Income Tax. But it is equally well established that enhanced values obtained from realisation or conversion of securities may be so assessable, where what is done is not merely a realisation or change of investment, but an act done in what is truly* ***the carrying on, or carrying out, of a business.*** *The simplest case is that of a person or association of persons buying and selling lands or securities speculatively, in order to make gain, dealing in such investments as a business, and thereby seeking to make profits. There are many companies which in their very inception are formed for such a purpose, and in these cases it is not doubtful that, where they make a gain by a realisation, the gain they make is liable to be assessed for Income Tax".*

[131] The Lord Justice Clerk then went on to articulate the time-honoured test to be applied in such cases (at 166):

> *"What is the line which separates the two classes of cases may be difficult to define, and each case must be considered according to its facts; the question to be determined being—***Is the sum of gain that has been made a mere enhancement of value by realising a security, or is it a gain made in an operation of business in carrying out a scheme for profit-making?***" [Emphasis added).*

[132] The relevant question to be asked in such cases is simple, viz, whether the gain in question is a **mere enhancement of value by realising a security or whether it was made in an operation of business in carrying out a scheme for profit-making.** Lord Justice Clerk further stated that:

> *"….it is not enough that the gain arose in the operation of business; it must also have arisen pursuant to the carrying out of a scheme for* profit-making. *Put another way, the distinction is between the profit that arises when property has been committed to a business as part of its stock in trade and is then realised in*

the course of trading operations and the gain that arises from a realisation of property not so committed. The former is taxable income, the latter not".

[133] In respect of the taxation consequences of gains by banks and insurance, New Zealand Court of Appeal in the recent decision on taxation of receipts by both banking and insurance businesses, in *CIR v. National Insurance Company of New Zealand Ltd*: (1999) 19 NZTC 15,135 stated:

"The principle expressed in the Californian Copper Syndicate case has been applied time and time again in considering the taxability of gains on the realisation of investments by banks and insurance companies. The nature of banking and insurance requires businesses in those fields to invest a substantial part of their funds in readily realisable investments in order to meet, in the case of banks, the demands of their customers and, in the case of insurers, the claims of policy holders. The realisation of such assets is a normal step in carrying on the banking (or insurance) business or in other words it is an act done in what is truly the carrying on of the business". [Ibid 15,138].

[134] Though the Californian Copper principle has been applied, 'in respect of the taxation consequences of gains by banks and insurance, its applicability depends on the different business activities of banking and insurance. The VAT consequences for trading banks which were different from the taxation treatment for life insurance company, which is obliged to invest in securities for the purpose of enhancing its insurance premiums collected from policyholders for the protection of the life insurance fund. It is relevant to note that the life insurance fund shall be the security of the policy-holders as though it belonged to an insurer carrying on **no other business than the life insurance business.** Accordingly, the interests of policy holders will not be affected from any other contracts of the insurer (e.g. investment business carried out without using the premium income of the policy holders) which does not involve any relationship between the premium income of the policy holders and the interest income derived from investing of premium income deposited in the life insurance fund.

[135] A thorough factual inquiry is warranted when considering the taxation implications of gains made by an insurance business with an investment element as opposed to a separate investment business using assets unrelated to life insurance fund. Now the question is whether the interest income from investment in securities was derived from the trading operations of an insurance business in the course of carrying on the business of supplying financial services or it was derived in the course of enhancing the life insurance fund to earn income which is part of the life insurance business.

[136] In terms of section 25 of the Regulation of Insurance Industry Act, No. 43 of 2000, the Appellant as a registered insurer is statutorily obliged to invest 20% of its reserve funds from general insurance business and 30% of the assets from the life insurance business to invest in government securities. In this context of the insurance industry, it is trite that an integral part of the insurance business is to channel its premium receipts into productive activities such as investments in equities, securities and properties which would generate investment income to meet its liabilities arising from claims by policy holders (see- the judgment of the Singapore Court of Appeal in *Comptroller of Income Tax v. BBO (2014) SGCA)* 10, paragraph 20).

[137] A more detailed examination of the nature of the insurance business and its general consequential treatment for taxation purposes is found in the judgment of Hamilton J. in *The Liverpool and London and Globe Insurance Company v. Bennett (Surveyor of Taxes)* (1913) 6 TC 327, where Lord Mersey (at 379 and 380) stated;

> *"… It is well known that in the course of carrying on an insurance business large sums of money derived from premiums collected and from other sources accumulate in the hands of the insurers, and that one of the most important parts of the profits of the business is derived from the temporary investment of these moneys. These temporary investments are also required for the formation of the reserve fund, a fund created to attract customers and to serve as a standby in the event of sudden claims being made upon the insurers in respect of losses. It is, according to my view, impossible to say that such investments do not form part of this Company's insurance business, or that the returns flowing from them do not form part of its profits. In a commercial sense the directors of the Company owe a duty to their shareholders and to their customers to make such investments, and to receive and distribute in the ordinary course of business, whether in the form of dividends, or in payment of losses, or in the formation of reserves, the moneys collected from them…."*

[138] The High Court of Australia in *Colonial Mutual Life Assurance Society Limited v. Federal Commissioner of Taxation* (1946) 73 CLR 604 ("*Colonial Mutual Life Assurance*") took similar views at 619–620:

> *"But an insurance company, whether a mutual insurance company or not, is undoubtedly carrying on an insurance business and* ***the investment of its funds is as much a part of that business as the collection of the premiums. The purpose of investing the funds of the appellant is to obtain the most effective yield of income.*** *The diminution or increase in the capital value of the investment between the date of purchase and that of maturity, and the apportionment and deduction or addition over the intervening period of that*

diminution from or increase to the interest actually payable on the investment is a material ingredient in the ascertainment of this yield. In Konstam, Law of Income Tax*, 8th ed. (1940), p. 126, it is stated that "the buying and selling of investments is a necessity of insurance business; and* where an insurance company in the course of its trade realizes an investment at a larger price than what was paid for it, the difference is to be reckoned among its profits*; conversely, any loss is to be deducted." … [Emphasis added].*

[139] In *Marac Life Assurance Ltd. v. Commissioner of Inland Revenue [1986] 1 N.Z.L.R. 694* the Court of Appeal in New Zealand considered the relationship between the life insurance and investment, and Cooke J. said, at pp. 697-698:

> "***In the general sense all life insurance is investment***. *What distinguishes it from other kinds of investment is that the gain or yield, if there is one, depends on the contingencies of human life. That is the case as regards all these bonds. Under each a fixed sum, being more than the premium, becomes payable to the policyholder or his personal representative (the 10-year bond carrying as well participation in surplus), but the date on which that fixed sum becomes payable depends on whether or not the life assured is continuing. It is true that the sum is calculated by adding to the premium a given percentage, and compounding the resulting figure if necessary; but only if death happens to occur on an exact anniversary of the commencement of the risk will the sum correspond to interest for the actual use of money. No reason is apparent for describing these contracts as anything other than life insurance. In essence they are very closely linked with the contingencies of human life. A contract of life insurance is not the less such because it is for a short term." (see- further paragraph 187 of Fuji Finance Inc v Aetna Life Ins Co Ltd* [1997] Ch 173)" [Emphasis added].

[140] The Court of Appeal in *Fuji Finance Inc v. Aetna Life Ins Co Ltd* (Supra) further recognised that the investment element of a life insurance policy, which has become such a feature of modern insurance, is consistent with its characterisation as a life policy (page 187). These cases sought to identify the distinction between insurance business and investment business, and decide whether a contract is an investment contract or a life insurance contract with an investment element, or whether the earning of profits was done in the course of the business of supplying of financial services (e.g. in the nature of trade or business). I am of the view that while the interest income received from the investment of the life insurance fund is a normal part of the business of a life insurance company, the carrying on the business of supplying financial services in the form of trade or business, as the predominant intention of the business, is not part of life insurance company. The insurance company that carries on life

insurance business and invests the life insurance monies to enhance its income is as much a part of that business as the collection of the premiums. The purpose of investing the funds of the Appellant is thus to obtain the most effective yield of income.

Distinction between carrying on the business of supplying financial services and earning of income by investment

[141] Mr. Gunetilleke however, argued that the investment activities are ancillary or associated with the insurance business, and all such activities that are classified as financial services under section 25F(g) shall be considered as an integral part of the business income of the Appellant subject to VAT in financial services. On the other hand, Mr. Fernando's argument was that the mere fact that the investment income received by the Appellant is treated as business income does not mean that the Appellant is engaged in the business of supplying financial services. In this context, it is necessary to consider the distinction between the carrying on the business of supplying financial services and the earning of income for the mere enhancement of the value of the life insurance fund.

[142] The distinction between carrying on a business and earning income from investment in property was considered in the Indian case of *Saifuddin Alimohamed v. Commissioner of Income Tax, Bombay City* AIR1954 Bom 219 in the context of the income tax law. Dealing with Section 10 (1), Income Tax Act, Chagla, C. J., observed:

> "*Therefore, looking to the plain language used by the Legislature, what has been emphasised in this section is the fact of a business being carried on by the assessee. It is the assessee who carries on a business who is liable to pay tax under the head of business. It is rather significant to notice the difference in language in Section 10, and Section 9. Section 9 deals with tax under the head of property and that tax is payable by an assessee who is the owner of the property. So, in the case of property, what is emphasised by the Legislature is ownership. In the case of business, what is emphasised is not the ownership of the business,* ***but the fact of the business being carried on by the assessee [emphasis added].***

[143] The concept of "business" referred to in section 25A (1) of the VAT Act, must, however, constitute a "continuing activity which is predominantly concerned with the business of an specified institution or a person **carrying on the business of supplying of any financial services** to others for a consideration over a period of time" (see-*The National Society for the Prevention of Cruelty to Children v. Customs and Excise Commissioners* (1992) VATIR 417, 422). This means that a supply of

financial services defined in section 25F(g), is not taxable unless the insurance company is "carrying on the business of supplying of such financial services" such as a trading bank or a finance company or any unregistered person providing services similar to financial services provided by a finance company. The question is whether the interest income in question could be characterised as investment income derived from investment business rather than insurance business with an investment element, depends on the nature of the business activities of an insurance company.

[144] Now the question is whether the interest income from investment in securities and other instruments was derived from the trading operations of the insurance business in the course of carrying on the business of supplying financial services or it was derived in the course of enhancing the life insurance fund to earn income which is part of the life insurance business. The assessor has calculated VAT on financial services on the basis of the information provided by the Appellant in the audited statement of accounts with its returns. The assessor has clearly identified that the interest income was received from the activities connected to the life insurance section of the audited statement of accounts (see-page 85 of the TAC brief). At paragraph 64 of the written submissions filed on behalf of the Respondent, the Respondent without any proof states that "The Appellant does not maintain separate books to demonstrate that its investments for life insurance are isolated from all other investment income..".

[145] No observation has been made by the assessor in his letter dated 25.06.2014 (pp. 35-37 of the TAC brief) that the Appellant has failed to maintain separate accounts or that the interest income was derived either from the general insurance business or from other investment business other than life insurance business of the Appellant. In my view, the life insurance contract with the involvement of an investment element for the purpose of enhancement of value of the premium income cannot be splited into two separate contracts or separate parts and the amounts invested out of the life insurance fund are tied to the payment of the policy holders' monies in terms of the contract of insurance. In the absence of any finding by the assessor to that effect in his letter, I am of the view that the amounts invested out of the life insurance fund are tied to premium income of the policy holders and they shall be treated as part and parcel of the life insurance, which is exempted from VAT in terms of item (x) (i) of Part (b) of the First Schedule to the VAT Act.

[146] The Appellant has earned interest income from investing the life insurance fund of the policyholders in government securities and other instruments and received interest income from payments made to policy holders, granting loans to staff and other credit and equity transactions for the purpose of mere enhancement of the value of the premium income received from policy holders. The investment of the life insurance fund is a part of the life insurance business as the collection of the premiums. The purpose of the investment in government securities and other similar securities by a life insurance company, using the life insurance fund is not to grant loans and other credit facilities defined in section 25F(g), and trade in them similar to a finance company and a trading bank or an unregistered person providing services similar to services provided by a finance company. The purpose or the intention of investing the life insurance funds of the Appellant is to ensure security for the policy holders' life insurance fund or to obtain the most effective yield of income or to enhance the value of the life insurance fund.

[147] No evidence has been placed before Court that the Appellant was either permitted to engage in a finance business as a registered finance company or the Appellant is a person who is carrying on the business of supplying financial services similar to an unregistered finance company. No evidence has been placed before Court that the Appellant is engaged in any financial business other than life insurance business to be regarded as a company carrying on the business of supplying of financial services for the purpose of the VAT treatment under section 25A(1) of the Chapter IIIA of the VAT Act.

[148] In my view the investment activities of the Appellant were an integral part of the life insurance business with an investment element conducted by the Appellant and the interest income from investments form part of the life insurance business. The interest income was received for the purpose of mere enhancement of the value of the premium income by realizing a security which is not done in what is truly **the carrying on, or carrying out, of the business of supplying of financial services** with a profit-making purpose of a trading company.

[149] The interest income received from investment of premium income in securities and other similar instruments generated an income to the life insurance fund which may ordinarily give rise to an inference that it was a taxable business income for the purpose the income tax law, which is totally different from the treatment of VAT on financial services under the VAT Act.

Even if the income from investment is treated as an income from life insurance business within the meaning of the income tax law, for the purpose of VAT liability, it must be proved that the Appellant supplied a financial service as defined in section 25F, and that such financial service was done in the business of supplying financial services. In the present case, both requirements are not satisfied.

[150] The TAC has erred in failing to consider that the VAT principles are totally different from income tax principles and applied the income tax principles on the ground that the mere interest income earned from the investments form part of the business income and thus, the Appellant is liable to pay VAT on financial services. The TAC, in my view, has totally failed to consider that the life insurance is not a financial service enumerated in section 25F so as to constitute a chargeable financial service. The TAC has further failed to consider that the life insurance business is exempted from VAT and therefore, any value addition is exempted from VAT in terms of item (x) (i) of Part II(b) of the First Schedule to the VAT Act. The TAC has failed to consider that the investment of the life insurance policy holders' monies in Treasury Bills and other similar instruments is to ensure security for the policy holder and to enhance the value of the policyholders' fund and not as granting loans to the Government, policy holders, staff or other financial instrument holders etc. The TAC has failed to consider that no evidence has been placed before the assessor or the Respondent or the TAC that the Appellant was carrying on the business of supplying financial services defined in section 25A(1)(ii) read with section 25F of the VAT Act or the interest income was received from such other investment business not related to life insurance business.

[151] Mr. Gunetilleke however, heavily relied on the following paragraphs of the decision of this Court in *Peoples' Leasing and Finance PLC v. The Commissioner General of Inland Revenue* CA/TAX/001/2016 decided on 20.07.2021, in support of his contention that any person supplying financial services mentioned in section 25F where such value of supply exceeds the threshold limit as stated in section 25A(2) of the VAT Act, is liable for the purpose of VAT on financial services:

> *"[155] The situation is different where the company has received income on a continuous basis from the transactions carried out in the course of the business of trading in securities (i.e., sale or purchase of shares in the share market, which goes beyond the activity of a simple acquisition or sale of shares). Such*

transactions would be a supply of services provided for consideration as part of continuous commercial activities of such company.

[169] The issue is whether underwriting, sub-underwriting or subscribing of any equity security, debt security or participatory security is deemed to be a supply of financial services for the VAT purposes. A dividend, being a return for subscribing and contributing to any equity share capital, pursuant to an offer for subscription and purchasing of shares in the course of carrying on business of financial business, by financial companies, can be classified as a "supply of financial services".

[171]…….. If the Appellant being the holding company goes beyond the mere acquisition and holding of shares and becomes actively involved in carrying on financial business of trading in securities for generating income, the dividend payment regularly received as a consideration in the trading of shares may constitute a supply of financial service".

[152] It is relevant to note that the facts of case in *Peoples' Leasing and Finance PLC v. The Commissioner General of Inland Revenue (supra)* are totally different from the facts of the present case. The Peoples' Leasing and Fiannce PLC was admittedly a finance company registered with the Central Bank of Sri Lanka, and thus, it was regarded as a **specified institution** within the meaning of Section 25F of the VAT Act. It was clearly a Leasing and Finance PLC **carrying on the business of supplying financial services** identified in that case. Accordingly, the VAT liability of Peoples' Leasing and Finance PLC was decided completely on different factual and VAT law principles. As noted, the principles decided in the case of *Peoples' Leasing and Finance PLC v. The Commissioner General of Inland Revenue* (supra) will not apply to the Appellant who is only carrying on life insurance business with an investment element, and investing the policyholders' premium income for the sole purpose of enhancing the value of premium income of the life insurance fund.

[153] For those reasons, I hold that the TAC has erred in holding that the Appellant has supplied financial services as defined in section 25F of the VAT Act and that the Appellant is carrying on the business of supplying of financial services in terms of section 25A(1) read with section 25F of the VAT Act.

Conclusion

[154] For those reasons, I am of the view that the question of law No. 1 should be answered in favour of the Respondent and the questions of law Nos. 2, 3, 4, 5, 6, 7,

8 and 9 should be answered in favour of the Appellant. In the result, the questions of law referred must, in my opinion, be answered as follows :

Question (1)- No
Question (2) -Yes
Question (3) -Yes
Question (4) -Yes
Question (5) -Yes:
Question (6) -Yes
Question (7) -Yes
Question (8) -Yes
Question (9) -Yes:

[155] For those reasons, the determination made by the Tax Appeals Commission dated 25.06.2019 is annulled and the Registrar of this Court is directed to send a copy of this judgment to the Tax Appeals Commission

JUDGE OF THE COURT OF APPEAL

M. Sampath K.B. Wijeratne, J.

I agree.

JUDGE OF THE COURT OF APPEAL