

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

In the matter of an appeal on questions of law in terms of the Value Added Tax Act No. 14 of 2002 read together with the Tax Appeals Commission Act No. 23 of 2011 (as amended).

CA Case No: TAX 13/2018

Tax Appeals Commission Case No.

TAC/VAT/010/2015

HNB Assurance PLC,

No.10,

R.A. De Mel Mawatha,

Colombo 03.

And Presently,

No.30,

Sri Uththarananda Mawatha,

Colombo 03.

Appellant

Vs.

The Commissioner General of Inland Revenue,

Department of Inland Revenue,

Sir Chittampalam A. Gardiner Mawatha,

Colombo 02.

Respondent

Before: **M.C.B.S. Morais J.**

&

Annalingam PremashankerJ.

Counsel: Johan Corera with Shiyase de Livera and J. Weeratunga instructed by M/S Sarawanan Neelakandan Law Associates for the Appellant.

Chaya Sri Nammuni, DSG for the Respondent.

Written Submissions: By the Appellant – on 06.08.2024, 18.04.2024, 23.09.2019,
10.05.2019

By the Respondent – on 14.05.2019

Argued on: 16.03.2026

Decided On: **08.10.2026**

JUDGMENT

M.C.B.S. Morais J.

This is an appeal by way of case stated against the determination of the Tax Appeals Commission (TAC) dated 22nd of March 2018, in the case of TAC/VAT/010/2015.

This appeal is filed under Section 11A(1) of the Tax Appeals Commission Act No. 23 of 2011 (as amended).

The tax in dispute is against the assessment made for the taxable period from January 2010 to December 2010 and the Value Added Tax (VAT) in dispute is amounting to Rs. 22,904,735.00.

FACTUAL BACKGROUND

The HNB Assurance PLC (hereinafter will be referred to as the Appellant) is a Public limited liability company incorporated and domiciled in Sri Lanka. The principal business activity of the Appellant is engaging in the Family (Life) Insurance and General Insurance business.

The Appellant has submitted the return for the taxable periods from January 2010 to December 2010, which were rejected by the Assessor by the intimation letter dated 21st of December 2012 on the basis that the Appellant has not declared the amount received as reinsurance commission in computing VAT. Accordingly, the Assessor has issued the Notice of Assessment dated 26th of April 2013 for the reasons set out in the intimation letter.

The Appellant being aggrieved by the decision of the Assessor, made an appeal to the Commissioner General of Inland Revenue (hereinafter will be referred to as the Respondent). The Respondent in his determination dated 21st of May 2015 determined the appeal by upholding the assessment issued by the Assessor. The Appellant being dissatisfied with the said determination of the Respondent, made an appeal to the Tax Appeals Commission (TAC) on the basis that the assessment issued by the Assessor for the periods January and February are time barred. The TAC after considering the submissions made by both parties made the determination dated 22nd of March 2018 in favor of the Respondent.

Being dissatisfied with the said determination, the Appellant has requested the TAC to cause a Case Stated to the Court of Appeal on the following Questions of Law.

I.

(a) Has the Tax Appeals Commission erred in determining that the assessments for the taxable periods of January 2010 and February 2010 are valid after the Tax Appeals Commission has made a determination of the fact that the said assessments (for January 2010 and February 2010) have been made and/or issued after the expiry of three years from the end of the said taxable periods?

(b) Where the said assessments out of time under section 33 of the Value Added Tax Act No. 14 of 2002?

(c) Are the said assessments relating to the taxable periods of January 2010 and February 2010 invalid?

II.

(a) Has the Tax Appeals Commission erred in determining that 'loss is supplied by the Appellant under a re-insurance agreement with the re-insurer?

(b) Has the Tax Appeals Commission erred in determining that the reinsurance agreement relates to 'supply of loss'?

(c) Has the Tax Appeals Commission erred in determining that the reinsurance recovered by the Appellant is a 'taxable supply' in terms of the Value Added Tax Act?

III.

(a) The Tax Appeals Commission having come into finding that there was no assessment and appeal for the month of March 2010, has the said Commission erred in determining to confirm the determination of the Commissioner General as the determination of the Commissioner General included a purported assessment for the period of March 2010?

(b) The Tax Appeals Commission having accepted and/or determined that there was no assessment and appeal for the month of March 2010 before the Commission has the said Commission erred determining and/or requiring the Commissioner General to take into consideration the amendment to be made when deciding the total amount due from the Appellant?

IV. Has the Tax Appeals Commission erred in making a determination confirming the determination made by the Respondent when the Tax Appeals Commission has accepted and/or determined that there was no assessment and appeal for the month of March 2010 before the Commission?

V. Has the Tax Appeals Commission failed to make a determination on the Appellant's grievance that the assessment is excessive?"

ANALYSIS

The Question of law No. I is in relation to the time limitation in issuing an assessment for the taxable periods January and February 2010 under the Value Added Tax Act No.14 of 2002 as amended (VAT Act) by the Assessor. Since this matter challenges the validity of the assessments issued, I shall initially address this issue.

The Question of Law No.III and IV are in relation to the validity of the assessment issued for the taxable period of March. Therefore, I shall discuss it separately.

The Question of Law No.II is the substantive issue in question and it is in relation to the reinsurance recoveries received by the Appellant and whether it is subject to VAT under the VAT Act. Since this question relates to all the taxable periods. Therefore, I shall discuss the said substantive issue separately.

Question of Law No. I

It is the contention of the Appellant that the VAT returns for the taxable periods January 2010 and February 2010 were made respectively within the specified time limits and was rejected by the Assessor. The reasons for the said rejection have been communicated to the Appellant by the intimation letter dated 12th of December 2012. Subsequently, the Notice of assessment dated 30th of December 2012 was issued to the Appellant, which is claimed to have been received on 26th of April 2013. Therefore, it is the Appellant's position that the Assessment issued by the Assessor is time barred under section 33(1) of the VAT Act.

However, it is the Respondent's position that the said assessment is made well before the three year time period prescribed by law since the letter of intimation has been issued on time. The Respondent further contends that the three year time period under section 33(1) of the VAT Act is only applicable to the 'making of the assessment' and not applicable for the subsequent 'Notice of Assessment' issued to the tax payer.

The TAC in agreement with the arguments made by the Respondent has held in the following manner in the determination dated 22nd of March 2018.

“Respondent submitted that though the computer printed notice of assessments was issued on 26.04.2013, the letter of intimation for the rejection of Returns of the Appellant Company, in terms of section 29 of the VAT Act, had been issued by the Assessor, on 21.02.2012, and the assessments had been made on 30.12.2012, within the said three year period.

It is to be noted that these two assessments were not issued separately but as two assessments among the assessments issued for the entire period of two years, as a consequence to the fact, when it was revealed that Appellant has not declared relevant

reinsurance receipt for the year 2010. The Notices of Assessment in respect of two Assessments, for the taxable periods of January and February 2010, had been issued on 26.04.2013 along with other assessments for the entire period of the year. Accordingly, in respect of the first taxable period of January 2010, the delay that had taken place over the three year period, as stipulated in section 33 (1) of the VAT Act, was less than three months (only two months and twenty six days) and the second one, for February was less than two months.

...

Therefore, it is our view that it is valid for the assessor to issue an assessment in order to assess the correct amount due to the government revenue, within a reasonable period of few months after three years when it was revealed that certain receipts which should have been declared by the Appellant in fact had not been revealed. ”

According to the time limitation stipulated under section 33(1) of the VAT Act, for a tax return made within the time limits stipulated by law, the Assessor is required to issue the assessment within three years from end of the specified taxable period for which the return was furnished. Therefore, when considering the facts of the case, the Assessor is required by law to issue the assessment for the taxable period January 2010, on or before 30th of January 2013 and the assessment for the taxable period February 2010, on or before 28th of February 2013.

The section 33(1) of the VAT Act, which deals with the time limitation for the assessment issued by the Assessor, reads in the following manner;

*“33. (1) Where any registered person has furnished a return under sub section (1) of section 21 in respect of a taxable period or has been assessed for tax in respect of any period, **it shall not be lawful for the Assessor** where an assessment –*

(a) has not been made, to make an assessment; or

(b) has been made, to make an additional assessment; after the expiration of three years from the end of the taxable period in respect of which the return is furnished or the assessment was made as the case may be.

(2) Notwithstanding the provisions of subsection (1) where the Assessor is of opinion that a person has wilfully or fraudulently failed to make a full and true disclosure of all the material facts necessary to determine the amount of tax payable by him for any taxable period, it shall be lawful for the Assessor where an assessment –

(a) has not been made, to make an assessment ; or

(b) has been made, to make an additional assessment,

withina period of five years from the end of the taxable period to which the assessment relates.

For the purposes of this Chapter any notice of assessment may refer to one or more taxable periods..”[emphasis added]

This Court, relying on the latest decision of the Supreme Court in **Fonterra Brands¹**, has adopted a similar approach in several previously decided cases, holding that the process of assessment is completed only when the assessment is communicated to the taxpayer by way of a notice duly served within the time limit required by law.

When considering the time limit mentioned above, the Assessor is required by law to furnish the intimation letter and the Notice of Assessment for the period of January 2010 on or before 30th of January 2013 and for the period of February 2010 on or before 28th of February 2013 respectively. However, it is the contention of the Appellant that the said Notice of Assessment is

¹ Fonterra Brands Lanka (Private) Limited V. The Commissioner General of Department of Inland Revenue and others (2025) SC Appeal 187/2014.

received by the Appellant on 26th of April 2013, which is after three years of time required by law.

On the contrary, the Respondent contends that the said delay can be justified under the proviso to section 33(1) of the VAT Act on the basis that there was a willful non-disclosure on the part of the Appellant. It is the position of the Respondent that the Appellant had failed to include the reinsurance recovery receipt of Rs. 111,428,127.00 in the VAT returns submitted by the Appellant, and that it was the statutory duty of the Appellant to disclose all the receipts, irrespective of whether such receipts fell within the definition of taxable supplies.

However, upon the perusal of the materials presented before this court, it should be noted that, if the Appellant had deliberately failed to disclose the said receipt with the intention of evading VAT, it is unlikely that the Appellant would have disclosed the said amount in its Financial Statements. Upon considering the Financial Statements submitted by the Appellant, it is apparent that the said amount had in fact been disclosed therein. Therefore, it can reasonably be inferred that the Appellant had omitted the said amount from its VAT returns on the basis that the said reinsurance recoveries are not subject to VAT.

In these circumstances, this Court finds no sufficient basis to accept the Respondent's contention that the Appellant had willfully failed to disclose the said receipt to the Respondent. Accordingly, this Court is of the view that the ordinary time bar prescribed under section 33(1) of the VAT Act remains applicable to the Respondent.

When the relevant dates are considered, it is apparent that the Notice of Assessment was received by the Appellant on 26th April 2026, which was well after the expiry of the three-years time period prescribed by law.

Accordingly, this Court holds that the assessments issued by the Assessor in respect of the taxable periods; January 2010 and February 2010 are time-barred under section 33(1) of the VAT Act.

Therefore, I answer the Question of Law No. I in the Affirmative.

Having answered the Question of Law No. I in the above manner, I shall now discuss the Questions of law No. III and IV.

Questions of Law No. III and IV

It is the contention of the Appellant that no VAT return was furnished for the taxable period of March 2010, on the basis that there had been no value addition during the said period. However, the Assessor in the intimation letter dated 21st of December 2012 has included a VAT liability by dividing the total reinsurance recoveries equally amongst all 12 taxable periods, including the month of March 2010. This position of the Assessor has been upheld by the Respondent in its determination dated 21st of May 2015. Accordingly, the Respondent has confirmed the assessment made by the Assessor and imposed the additional VAT liability of Rs. 1,114,281.00 for the taxable period of March 2010.

This position is reflected in the intimation letter and in the reasons for the determination of the Respondent dated 11th August 2015, which states as follows:

“Having considered the submissions and facts tendered by both parties the appellant with his authorized representative M/S Amarasekara & Co. and the representatives of

Inland Revenue Department (IRD). I determined to confirm the assessments on the above mentioned reasons.

Accordingly Additional VAT calculations are as follows;

Taxable periods		Reinsurance Recoveries (Rs.)	Additional VAT Liability (Rs.)
January	2010	9,285,677	1,114,281
February	2010	9,285,677	1,114,281
March	2010	9,285,677	1,114,281
April	2010	9,285,677	1,114,281
May	2010	9,285,677	1,114,281
June	2010	9,285,677	1,114,281
July	2010	9,285,677	1,114,281
August	2010	9,285,677	1,114,281
September	2010	9,285,677	1,114,281
October	2010	9,285,678	1,114,281
November	2010	9,285,678	1,114,281
December	2010	9,285,678	1,114,281
			<u>13,371,372</u>

Abeyssekara
A.D.I.S. Abeyssekara
Commissioner

Upon consideration of the facts and circumstances of the case, it is apparent that the Appellant had not furnished a VAT return for the taxable period of March 2010, and this fact is not in dispute. However, the Appellant contends that, notwithstanding the absence of a VAT return for the said period, the Assessor proceeded to impose an additional VAT liability in respect of March 2010 without properly considering whether a return had in fact been furnished for that period.

In considering the above contention, it is necessary to examine the powers vested in the Assessor to make an assessment. In terms of section 28(1)(a) of the VAT Act, where a registered person, who in the opinion of the Assessor is chargeable with tax, fails to furnish a

return for any taxable period, the Assessor is empowered to make an assessment in respect of that taxable period. The relevant provision reads as follows:

“28. (1) Where –

(a) any registered person who in the opinion of the Assessor is chargeable with tax, fails to furnish a return for any taxable period; or

...

the Assessor shall assess the amount of the tax, which such person, in the judgement of the Assessor, ought to have paid for that taxable period and shall, by notice in writing, require such person to pay such amount forthwith. The amount so assessed in respect of any person for a taxable period shall, be deemed to be the amount of the tax payable by him for that taxable period.”

It is therefore clear from the above provision that the Assessor is vested with the statutory power to assess the amount of tax which, in his judgment, ought to have been paid by a taxpayer for the relevant taxable period and to require the taxpayer, by notice in writing to pay the amount so assessed.

However, section 21 of the VAT Act imposes an obligation upon a taxpayer to furnish a return in respect of a specified taxable period within the time prescribed by law. Further, section 21(10) provides for the steps that may be taken by the Assessor where a taxpayer has failed to furnish such return. In the present case, however, it appears that the Assessor did not take the steps contemplated under section 21(10) or section 28 and instead proceeded to include the said VAT liability in the intimation letter.

The question that therefore arises for determination is whether, in such circumstances, the Assessor is entitled to impose a VAT liability in the intimation letter of another taxable period without assessing the VAT for the taxable period of March 2010. Even if such assessment was not issued can it be issued at any subsequent time without regard to the limitation prescribed by law.

Upon consideration of the material placed before this Court, I am of the view that there are no sufficient grounds to invoke section 33(2) of the Act in determining the time limitation. There has been no established allegation of a wilful or fraudulent failure on the part of the Appellant in submitting material information to the Respondent. Although the Respondent has sought to contend that the failure was wilful or fraudulent, such contention has not been established before this Court.

Furthermore, it needs to be noted that the Assessor in the present circumstance has only included an additional tax liability on the Appellant in the Intimation letter dated 21st of December 2012. However, consequently has failed to issue an assessment by way of notice to the taxpayer for the period of March 2010 to indicate the quantum of the tax liability to be paid. Furthermore, the said assessment for the taxable period March 2010 has not been issued to the Appellant until this date.

In the circumstances, I am of the view that where the Assessor seeks to make an assessment under section 28 of the Act, such assessment must be made within the period prescribed by section 33(1). The mere failure of a taxpayer to furnish a return does not, in my view, confer upon the Assessor an unrestricted power to issue an assessment at any time thereafter.

Therefore, this court is of the view that there has been no valid assessment issued by the Assessor for the Month of March 2010.

Accordingly, this Court is satisfied that the action of the Assessor in imposing an additional VAT liability of Rs. 1,114,281.00 for the taxable period of March 2010 is not in accordance with the applicable provisions of law. Accordingly, the TAC has erred in determining that the said assessment issued for the period of March 2010 is valid in law.

Therefore, I answer the Question of law No. III and Question of Law No. IV in the Affirmative.

Question of Law No. II

The Question of Law No. II relates to the reinsurance recoveries received by the Appellant, which the Appellant contends to be not subject to VAT on Financial Services. Before considering the legal issue before this court, it is appropriate to set out the relevant factual background related to the issue at hand.

The Appellant is a public limited liability company engaged in the business of Life Insurance and General Insurance. The Appellant has paid VAT on general insurance premiums and other income which it accepts as being liable to VAT. It is also relevant to consider that the VAT payable in respect of the insurance business is ultimately borne by the policyholder through the premium charged by the Appellant. The Appellant, as the insurer, receives the premium inclusive of the amount attributable to VAT and is required to remit the relevant VAT to the Commissioner-General of Inland Revenue in accordance with the provisions of the VAT Act.

In the course of carrying on its insurance business, the Appellant has entered into reinsurance agreement with a foreign entity/reinsurer for the purpose of sharing the risks arising from primary insurance contracts. However, the Assessor has treated the reinsurance recoveries received by the Appellant as consideration for the supply of service of providing losses and issued the relevant assessment for the said taxable periods accordingly.

The position of the Appellant is that the reinsurance recoveries received from the reinsurer falls outside the scope of the VAT Act and therefore, it is not liable to VAT under the Act.

Before determining the substantive issues, it is necessary to understand the nature and operation of the insurance and reinsurance business and the manner in which VAT applies to an entity engaged in such business.

Insurance may generally be understood as a contractual arrangement under which an insurer assumes a specified risk of an insured person in return for the payment of a premium. The insurance contract identifies the nature of the risk assumed, the extent of the insurer's liability and the period during which the risk is covered. The risk assumed by the insurer therefore constitutes the subject matter of the insurance contract.

In consideration of the insurer assuming such risk, the insured is required to pay an insurance premium. The obligation of the insurer under the contract is, subject to its terms and conditions, to indemnify the insured in the event that the insured risk materialises and results in the loss or damage contemplated by the policy. In the case of general insurance, where the insured event does not occur during the period of the policy, the insured would ordinarily not be entitled to a refund of the premium merely because no claim was made.

For example, where a motor vehicle is insured for a specified period and for a specified sum, and an accident occurs during that period which is covered by the policy, the insured is entitled, subject to the terms and conditions of the policy, to be indemnified by the insurer for the loss or damage suffered to the extent of the insurer's liability. However, if no such accident or other insured event occurs during the period of the policy, the insured would ordinarily not be entitled to a refund of the premium merely because no claim was made.

Reinsurance, on the other hand is an arrangement between an insurer and another insurance company known as the reinsurer. Under such an arrangement, the insurer passes on all or part of the risk which it has undertaken under the original insurance contracts to the reinsurer. The insurer transferring the risk is commonly referred to as the ‘Cedant’.

Therefore, where part of the risk has been reinsured and the insured event subsequently occurs, the insurer may recover from the reinsurer the portion of the loss of the policyholder for which the reinsurer has agreed to provide cover, subject to the terms of the reinsurance agreement. The amount so recovered by the insurer/reinsured is generally referred to as a ‘reinsurance recover’.

Accordingly, the Appellant claims that the re-insurance recoveries received by the Appellant is not a supply of services liable under the VAT Act. The Appellant further contends that it has made a re-insurance agreement only for the purpose of sharing risk based on the re-insurance contract for which a premium has been paid to the re-insurer, outside Sri Lanka. On this basis the Appellant argues that there has been no service provided by the Appellant to the re-insurer. It is further contended that it is the re-insurer who provides a service to the Appellant.

Accordingly, when the appeal was made to the TAC, the TAC has considered the losses of the policyholders to be a service provided by the insurer to the reinsurer and therefore, have considered the ‘loss’ as supply of service.

The TAC in arriving at its decision dated 22nd of March 2018, has held in the following manner;

“As there is a supply of a service taking place in relation to the present case, under both situations, the next common requirement would be that the service referred to should be consumed outside Sri Lanka, if one were to gain eligibility to a zero rated status. By definition, 'supply of services' includes 'any loss for which an indemnity is due'.

In the present case, the 'loss to be supplied to the re-insurer, to be indemnified' by the Appellant Company is the 'supply of service' to be made, in terms of the above definition. The 'loss' sustained by the Appellant arose as a result of the payment of the insurance claim made by the insured in Sri Lanka. As the Appellant has already insured the risk of incurring this loss with the re-insurer, there is an indemnity due to cover this loss. Accordingly, irrespective of the place where the re-insurance agreement was negotiated, the significance of the re-insurance agreement is that this re-insurance agreement provides a platform to deal with this loss with the re-insurer. Accordingly, being on that platform, the said supply of service is made in Sri Lanka to the foreign re-insurer, to be consumed by him. This assertion is in full conformity with section 9 of the VAT Act as to the "services supplied in Sri Lanka".

...

Therefore, being a Company domiciled in Sri Lanka, the Appellant Company suffered the loss - being in Sri Lanka - and accordingly, the loss is supplied as a service in Sri Lanka, to be dealt in Sri Lanka and to be consumed in Sri Lanka. Once the service supplied is actually consumed in Sri Lanka, the Appellant Company is relieved of the loss suffered. That event would take place once the Appellant Company actually receives the claim from the re-insurer. Thus, the loss is finally consumed in Sri Lanka. In the circumstances, it is our view that in terms of section 7 (1) (b) and 7 (1) (c) the re-insurance commissions received are not eligible to gain zero rated taxable status and, therefore, the value of such supplies are liable for VAT at the normal rate. On the same grounds, such supplies would not qualify to be treated as an exempt supply under item (xxii) of the First Schedule of the VAT Act."

Therefore, the matter before this court gives rise to two essential questions to be answered; namely,

1. Whether the impugned reinsurance recoveries received by the Appellant to be ataxable 'supply of service' under section 83 of the VAT Act. And

2. If it is so, whether the said recoveries received by the Appellant is a zero-rated supply under the VAT Act.

Before addressing these questions, it is useful to briefly examine the law governing the Value Added Tax in Sri Lanka.

The section 2(1) of the VAT Act set outs the requirements in imposing a VAT. The specific provision is mentioned below for reference.

“2. (1) Subject to the provisions of this Act, a tax, to be known as the Value Added Tax (hereinafter referred to as “the tax”) shall be charged –

*(a) at the time of supply, on **every taxable supply of goods or services**, made in a taxable period, by a registered person in the course of the carrying on, or carrying out, of a **taxable activity** by such person in Sri Lanka;*

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

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 following rates —

....

on the value of such goods or services supplied as referred to in the Fourth Schedule, other than such goods chargeable with the tax at zero per centum;”

According to the above provision, VAT is charged at the time of supply, on every taxable supply of goods or services made by a registered person during a specified taxable period, in the course of carrying on or carrying out a taxable activity in Sri Lanka. The tax is imposed on the value of the goods or services supplied as referred to in the Fourth Schedule and subject to the provisions relating to zero-rated supplies.

It is uncontested by parties that the Appellant is engaged in a taxable supply relate to insurance business, however, the contention is whether the re-insurance recoveries received subsequently by way of the re-insurance contract between the Appellant and the re-insurer is subject to VAT on the basis that re-insurance recoveries received is in return for the supply of losses.

At this stage, it is pertinent to understand whether the supply of services that is under reference, becomes a taxable activity. To have a better understanding, I shall now refer to the interpretation of ‘supply of services’ under section 83 of the VAT Act. The said Act interprets the supply of services as follows,

““supply of services” means any supply which is not a supply of goods but includes any loss incurred in a taxable activity for which an indemnity is due;”

When considering the facts of the case it should be taken into account that the interpretation section refers to the business of the insurance in line with the original contract entered between the insurer and the insured, to which an indemnity shall be due when a loss is occurred in the cause of a taxable activity. However, it is pertinent to note that the said provision does not infer or refer it to be applied to a situation of re-insurance recoveries received by the re-insured as it is considered as a part of the payment made to the policyholder.

At this stage it is important to understand the distinction between insurance indemnity and reinsurance recoveries.

An indemnity represents the insurer’s share of the risk assumed by the insurer which becomes payable when a loss is covered by the original insurance policy occurs. The primary insurer remains liable to the original policyholder.

A reinsurance recovery is an amount received by an insurer from a reinsurer under a reinsurance arrangement in respect of a risk or liability undertaken by the insurer under the original insurance

policy. Where the insurer becomes liable to indemnify the original policyholder for a covered loss, the reinsurer will be liable in accordance with the terms of the reinsurance agreement to bear the agreed portion of that liability. The amount subsequently recovered by the insurer from the reinsurer is therefore referred to as a reinsurance recovery.

This distinction is important in the present case. The reinsurance recoveries received by the Appellant are amounts recovered from the reinsurer in respect of the indemnity payable to the original policyholder. It is not the payment received to compensate the Appellant for a loss suffered by the Appellant on its own account. Therefore, an indemnity arising under an insurance agreement and a reinsurance recovery should not be treated as one and the same.

Further, the definition of “supply of services” in section 83 of the VAT Act is not limited to the conventional supply of services. It expressly includes “any loss incurred in a taxable activity for which an indemnity is due”. Accordingly, where a person carrying on a taxable activity incurs a loss and an indemnity becomes due in respect of that loss, such indemnity falls within the statutory definition of a supply of services.

This position in relation to the original insurance contract has been taken up in the case of *Sojitz Kelanitissa (Private) Limited V. The Commissioner General of Inland Revenue and Other* CA/Writ/19/2013 decided on 18.09.2023. His Lordship Mayadunne Corea J., has analyzed the application of the ‘supply of services’ in relation to the original insurance contract.

However, in the present case, the Appellant had not entered into the reinsurance agreements for the purpose of claiming compensation for any loss or damage suffered by the Appellant itself. On the contrary the reinsurance agreements were entered into share with the reinsurers the risks undertaken by the Appellant in respect of the original policyholders. Accordingly, when a loss covered by the original insurance policy occurred, the liability of the reinsurer shall arise in accordance with the terms of the reinsurance agreement.

Having considered the facts and circumstances of the case and the nature and operation of the reinsurance contracts, it is necessary to note that the Appellant entered into the said agreement to share with the reinsurer the risks undertaken under the original insurance policies. When a loss covered by an original policy occurs, the Appellant becomes liable to indemnify the policyholder in accordance with that policy. The VAT in relation to the said original insurance business is already paid by the Appellant. However, the corresponding payment by the reinsurer arises from the reinsurer's agreed share of the risk under the reinsurance agreement and is not compensation for a loss suffered by the Appellant itself.

Accordingly, the amount received from the reinsurer cannot in the circumstances of this case be regarded as an indemnity for a loss incurred by the Appellant in carrying on its taxable activity within the meaning of "supply of services" under the VAT Act. The reinsurance recovery represents the reinsurer's agreed share of the risk arising from the original insurance policy, rather than an indemnity for a loss incurred by the Appellant. Furthermore, if we are to consider the position of Respondent that the Appellant had in fact 'supplied a service of loss', then both the original policyholder as well as the insurer will be considered to have supplied losses for which an indemnity is due and it is not the intention of the legislature to apply on the insurer a subsequent VAT liability by a novel approach.

Therefore, I am of the view that the re-insurance recoveries received by the Appellant does not connote that the Appellant has provided a taxable "supply of services" under the VAT Act. Accordingly, the Assessor/Respondent cannot widen the scope of section 83 so as to impose a liability on the Appellant in respect of the re-insurance recoveries received.

The Appellant further contends that the re-insurance recoveries recognized in the financial statements of the company was in the nature of a reduction or discount from the re-insurance premium payable, and was merely a book entry made in the financial statements in accordance with industry practice. Therefore, it is the position of the Appellant that even if the said re-insurance recovery is considered for the purposes of VAT, it should either be zero-rated or exempt as the supply was made outside Sri Lanka.

The TAC having considered the submissions made by parties has held in the following manner;

"In the present case, the 'loss to be supplied to the re-insurer, to be indemnified' by the Appellant Company is the 'supply of service' to be made, in terms of the above definition. The 'loss' sustained by the Appellant arose as a result of the payment of the insurance claim made by the insured in Sri Lanka. As the Appellant has already insured the risk of incurring this loss with the re-insurer, there is an indemnity due to cover this loss. Accordingly, irrespective of the place where the re-insurance agreement was negotiated, the significance of the re-insurance agreement is that this re-insurance agreement provides a platform to deal with this loss with the re-insurer. Accordingly, being on that platform, the said supply of service is made in Sri Lanka to the foreign re-insurer, to be consumed by him. This assertion is in full conformity with section 9 of the VAT Act as to the "services supplied in Sri Lanka".

In terms of section 9 of the VAT Act, "services shall be deemed to be supplied in Sri Lanka where the supplier carries on or carries out a taxable activity in Sri Lanka and the services are performed in Sri Lanka by the supplier....."

The Appellant Company has suffered the loss in Sri Lanka and therefore, it is supplied in Sri Lanka to be consumed or utilized in Sri Lanka, as in the case of consuming any other service. Here, the consumption or utilization is the use of the loss in order to restore the status quo of the Appellant Company. It is an action taken to make the loss good, by the re-insurer. It is to be consumed by the re-insurer by making necessary reviews in Sri Lanka, where the loss has actually taken place, and following the due procedures. If the re-insurer agrees to consume the loss, after the review made in Sri Lanka to satisfy him about the circumstances which caused the claim to be made, the payment would be made in accordance with the condition of the re-insurance agreement. When the payment is received by the Appellant, the consumption of the loss sustained by the Appellant also takes place and only then would the loss be made good."

The TAC having initially arrived at a decision that the Appellant is supplying loss as a service has subsequently deviated and held otherwise.

For arguments sake, even if we are to consider that the Appellant is involved in a taxable supply and therefore is liable to VAT, the said re-insurance commission shall be zero-rated in terms of section 7(1)(c) of the VAT Act. It is relevant to note that in order for section 7(1)(c) to apply, the relevant service must first be a taxable supply.

For ease of reference, I shall reproduce the section 7 of the VAT Act below;

“7. (1) A supply of –

(b) services shall be zero rated where the supply of such services are directly connected with –

(c) any other service, being a service not referred to in paragraph (b) , provided by any person in Sri Lanka to another person outside Sri Lanka to be consumed or utilized outside Sri Lanka shall be zero rated provided that payment for such service in full has been received in foreign currency from outside Sri Lanka.”

In this regard, section 7(1)(c) provides for the zero- rating supplies in respect of services supplied to persons outside Sri Lanka. In terms of the above provision, a service other than a service referred to in section 7(1)(b) provided by a person in Sri Lanka to another person outside Sri Lanka which is to be consumed or utilized outside Sri Lanka, shall be zero-rated provided that the payment in full for such service is received in foreign currency from outside Sri Lanka.

Therefore, for a service to fall within section 7(1)(c), it is necessary to fulfill the following requirements.

1. The service should be provided by a person in Sri Lanka to a person outside Sri Lanka.

2. The service should be consumed or utilized outside Sri Lanka, and
3. The payment in full for such service should be received in foreign currency from outside Sri Lanka.

Where these requirements are satisfied, the supply is treated as a zero-rated supply for the purposes of VAT.

When considering the circumstances of the transaction in question, it is apparent that the Appellant being the re-insured is domiciled in Sri Lanka while the re-insurer is a foreign entity which has agreed to share the risks undertaken by the Appellant. Assuming that the Appellant was providing losses, which was to an entity outside Sri Lanka the second limb of the above provision is satisfied. Moreover, the said recoveries were received by the Appellant in foreign currency. In these circumstances, I am of the view that the requirements set out in section 7(1)(c) of the VAT Act have been satisfied. Accordingly, the re-insurance recoveries are entitled to be treated as zero-rated supplies.

Therefore, I am of the view that, even if the Respondent's argument is accepted that the Appellant supplied services in respect of the losses in return for the reinsurance recoveries received, such recoveries would nevertheless be zero-rated under section 7(1)(c) of the VAT Act.

It is further apparent from the material before this Court that the VAT treatment adopted in respect of the preceding months of January and February was not challenged. The fact that the VAT position for those months was not questioned is a relevant circumstance to be considered in determining the issue before this Court in respect of the month of March.

At this juncture, it is pertinent to note that the Value Added Tax (Amendment) Act No. 09 of 2011, under item (3) (xxxiv) of the PART II of the First Schedule specifically exempt reinsurance receipts, with effect from 1 January 2011, in the following terms:

“(xxxiv) services being receipts from reinsurance by any local insurance company by way of commission or compensation in an insurance business (with effect from January 1, 2011);

The said amendment is subsequent to the taxable period under consideration and therefore, cannot be applied to the present case. Nevertheless, the introduction of this specific exemption is relevant in considering the manner in which reinsurance receipts were understood under the preceding law. It appears that the subsequent amendment was intended to clarify the treatment of such receipts with regard to the interpretation that had been placed on the previous provision.

Furthermore, it needs to be noted that this is the first instance the Appellant is being taxed for the reinsurance recoveries under the VAT regime; this clearly shows that there has been a lacuna in the Law which has been rectified under the subsequent Amendments made in 2011 and 2025.

For the foregoing reasons, I answer Questions of Law Nos. II (II(a), II(b), II(c)) in the affirmative. Accordingly, the re-insurance recoveries received by the Appellant pursuant to the re-insurance contract is not liable to VAT under the VAT Act. Therefore, I am of the view that the TAC has erred in holding otherwise.

Therefore, the Question of Law No.III and IV , are answered in the Affirmative. Therefore, the said assessment made for the taxable periods March, April, May, June, July, August, September, October , November and December of the year 2010 are null and void.

CONCLUSION

When considering the facts and the circumstances of the case, in line with the materials presented before this court, I am of the considered view that the Questions of law formulated by the Appellant should be answered as set out below.

Question of law I (a) – Affirmative

Question of law I (b) – Affirmative

Question of law I (c) - Affirmative

Question of law II (a) – Affirmative

Question of law II (b) – Affirmative

Question of law II (c) – Affirmative

Question of law III (a) – Affirmative

Question of law III (b) – Affirmative

Question of law IV – Affirmative

Question of law V – need not be considered

This appeal is allowed.

Accordingly, the determination of the TAC dated 22nd of March 2018, and the determination of the Respondent dated 21st of May 2015 are hereby set aside and the assessment dated 26th of April 2013 issued by the Senior Assessor of the Department of Inland Revenue is null and void.

The Registrar is directed to issue a copy of this judgment to the Secretary of the Tax Appeals Commission for necessary actions.

Judge of the Court of Appeal

Annalingam Premashanker J.

I agree

Judge of the Court of Appeal