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

In the matter of an application of case stated under section 11A of the Tax Appeals Commission Act No. 23 of 2011 as amended by Act No. 20 of 2013.

CA Case No: CA/TAX/31/2014
Tax Appeals Commission No. TAC/OLD/ESC/002

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

Appellant

Vs.

Diamond Cutters Ltd,
No. 20-24,
Modarawila Industrial Estate,
Panadura.

Respondent

Before: **M.C.B.S. Morais J.**
&
Annalingam Premashanker J.

Counsel: Chaya Sri Nammuni, DSG for the Appellant.

Riad Ameen with Rushitha Rodrigo, instructed by M/S Paul Ratnayeke Associates for the Respondent.

Written Submissions: By the Appellant – on 22.11.2019, 23.11.2017, 30.09.2016

By the Respondent – on 01.07.2026, 23.12.2019,14.12.2018, 14.02.2017

Argued on: 01.12.2025

Decided On: **03.09.2026**

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 26th of August 2014, in the case of TAC/OLD/ESC/002.

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 Economic Service Charges (ESC) return submitted by the Respondent for the taxable period 2005/2006 and 2006/2007. Accordingly, the assessments in question include assessment No. 8565739, 8568756, 8565771, 8565801, 8565823. Thereby, the total taxable amount in dispute is Rs. 14,547,097.00 with a total penalty of Rs. 7,197,401.00.

FACTUAL BACKGROUND

The Diamond Cutters Ltd (hereinafter will be referred to as the Respondent) is a limited liability company incorporated and domiciled in Sri Lanka. The Respondent is engaged in the non-traditional industry of cutting and polishing rough diamonds and returning the same to the foreign owners and recovering the processing cost in foreign exchange. Accordingly, the earnings of the Respondent is received in foreign currency.

The Respondent has submitted the Economic Service Charges (ESC) return for the taxable period 2005/2006 and 2006/2007 in quarterly basis which was rejected by the Senior Assessor of the Economic Service Charge branch of the Department of Inland Revenue by the intimation letter dated 7th of November 2007. The Assessor has rejected the said returns on the basis that the ESC should be calculated on the basis of the turnover itself considering the CIF value and not the value of the Export under the Economic Service Charge Act No.13 of 2006 (hereinafter sometimes will be referred to as the 'ESC Act'). Accordingly, the Assessor has issued the Notice of Assessment dated 7th of March 2008 for the reasons set out in the intimation letter.

The Respondent 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 Appellant). The Appellant in his determination dated 5th of April 2010 determined the appeal by upholding the decision of the Assessor. The Respondent being dissatisfied with the said determination of the Appellant, made an appeal to the Tax Appeals Commission (TAC) on the basis that the assessment issued by the Senior Deputy Commissioner of the Department of Inland Revenue is void. The TAC after considering the submissions made by both parties allowed the appeal by the determination dated 26th of August 2014.

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 Question of Law.

I. *“Has the Tax Appeals Commission given its determination in respect of the appeal of Diamond Cutters Ltd, without considering the provisions regarding "relevant turnover" in section 2 (3) Economic Service Charge Act No. 13 of 2006?”*

Even though there is only one question of law raised by the Appellant in the case stated, subsequently with the agreement between the parties, according to the motion dated 11th of November 2022, the Appellant has raised the following questions of law, instead;

“I. Has the Assessor assessed the Respondent on the basis that the Respondent was acting as an Agent of the foreign customers (as the Respondent refers to them)?

II.

a) Was the Respondent acting as agent of the foreign customers (as the Respondent refers to them) when the Respondent engaged in cutting and polishing the diamonds that were sent to them?

b) Was there evidence before the TAC to that effect?

III.

a) If the Respondent was acting as agent of the foreign customers (as the Respondent refers to them) did the foreign customers receive any profit or income arising in or derived from Sri Lanka?

b) Was there evidence before the TAC to that effect?

IV. Should the definition of "relevant turnover" in Section 2 of the Economic Service Charge Act No.13 of 2006 in respect of the Respondent be calculated based on the Free on Board (FOB) value of the Diamonds sent by the Respondent to the foreign customers (as the Respondent refers to *them) or should it be calculated based on the amount received by the Respondent from them for cutting and polishing diamonds? "*

When considering the questions of law raised by the Appellant before this court, the main question is, in calculating the ESC under the ESC Act. The substantive issue is whether the turnover on the CIF Value should be included or the value of the Export itself should be considered on calculating the ESC. Since this issue goes to the root of the substantive issues raised, I shall address this issue at the outset, as for Question of law No. IV.

ANALYSIS

The Respondent's business is of two types;

1. Cutting and polishing the imported diamonds from its customers and exporting back the polished diamonds with its residues.
2. Buying diamonds based on the order placed, polish them accordingly and sell them to their clients accordingly.

There is no issue arisen in relation to the 2nd type of business stated above. However, the issue at hand is in relation to the 1st type, to wit, the business of cutting and polishing the rough diamonds imported from the customers and exporting back the polished diamonds to its customers. Therefore, only the 1st type of business stated above will be considered in this determination.

The Respondent is engaged in the business of providing services by cutting and polishing rough diamonds received from the foreign clients and receives a sum in return for the services rendered by the Respondent in foreign exchange as per the BOI agreement. Accordingly, the Respondent contends that they receive rough diamonds from the foreign clients, who are the owners of the said diamonds. Thereafter, the Respondent provides a service by cutting and polishing the said diamonds and in return gain a fee for the service of cutting and polishing the said rough diamonds. Accordingly, the polished diamonds are sent back to its owners with the diamond residues formed in cutting and polishing the said rough diamonds. The Respondent contends that he does not receive neither the value nor a sum based on the value of the diamond for the services provided by them.

On this basis, the Respondent contends that it is only required to pay ESC for the actual sum received by them for the services provided to its clients. Thereby, the Respondent contends that the turnover of the Respondent includes the amount received/receivable for the service of polishing the said rough diamonds of their client who are the actual owners of the said diamond. The Respondent further contends that it is not liable to consider the actual value of the diamond itself in calculating the ESC taxes since the Respondent does not receive payment for the value of the diamond but rather only for the services made by them as the polished diamonds are exported back to the original owners.

Accordingly, the Respondent contends that the Appellant has misinterpreted the provisions of the ESC Act, by reading it in line with the procedure laid down in the Value Added Tax Act and the Customs Ordinance.

It is the Appellant's position that the calculation of ESC should be based on the value of the diamond itself since, the Respondent has declared the value of the diamonds in the CUSDEC and their VAT returns under the Value Added Tax Act and the Customs Ordinance. Accordingly, the Appellant argues that for the purpose of ESC, the value of the diamond should be included. Further, the Appellant argues that the Respondent acting in the capacity of the Agent for the original owners of the said diamonds, is liable to calculate the ESC on the basis of the value of the diamond itself.

However, the Respondent contends that the procedure for the VAT return as well as return for customs are distinct under the unique provisions of law. Further, it is only the ESC Act which required the returns to be calculated on the 'turnover' of the said business. The Respondent further argues that it is not an agent of their client and this argument of the Appellant is only made at the appeal stage before this court, and even if the Appellant contends that the Respondent to be acting in the capacity of an agent for its clients then the Burden is on the Appellant to prove so, and there has been no evidence submitted to prove such claim. Therefore, it is the contention of the Respondent that the actions of the Appellant is not in conformity with law.

It needs to be noted that the fact that the Respondent only provides a service by cutting and polishing the rough diamonds received from its clients and that the Respondent does not receive a sum equivalent to the value of the diamonds, is not disputed by the Appellant.

When considering the arguments presented before this court, it is apparent that the principal question of law that needs to be addressed is encapsulated under Question of law No.IV. Therefore, I shall address it initially.

Question of Law No. IV

The ESC Act requires the Economic Service Charge to be calculated based on the 'turnover' of the specified entity. Accordingly, the question before this court is;

1. Whether the ESC payable by the Respondent is on the fee received/ receivable by the Respondent for the services provided by them to its customers, OR

2. Whether the ESC payable by the Respondent is on the Free On Board (FOB) value of the diamonds.

In determining the above issue, it is crucial to understand the standing provisions in relation to the Economic Service Charge in Sri Lanka.

Economic Service Charge (ESC) is a tax levied on a quarterly basis on the businesses under the Economic Service Charge Act No. 13 of 2006 as amended. The tax is charged on the total quarterly turnover of the business, if the required financial threshold is met.

According to section 2(1) of the Economic Service Charge Act No. 13 of 2006, the eligible entity is required to pay the ESC tax on the relevant turnover of the specified quarter at the appropriate rate specified in the ESC Act.

"2. (1) An Economic Service Charge (hereinafter referred to as " the service charge") shall, subject to the provisions of this Act, be charged from every person and every partnership for every quarter of every year of assessment commencing on or after April, I, 2006 (hereinafter in this Act referred to as "a relevant quarter") in respect of every part of the relevant turnover of such person or partnership for that relevant quarter, at the appropriate rate specified in the Schedule to this Act:

..."

However, in interpreting the phrase 'turnover', the section 2(3) of the ESC Act needs to be taken into account. The section 2(3) of the ESC Act defines the term 'turnover' in the following manner;

"(3) In this section—

(a) "relevant turnover" in relation to any person or partnership and to any relevant quarter means the aggregate turnover for that relevant quarter of every trade, business, profession or vocation carried on or exercised by such person or partnership, as the case may be, in Sri Lanka whether directly or through an agent or more than one agent :

Provided that the relevant turnover for any relevant quarter shall not include the turnover for that relevant quarter of any trade, business profession or vocation, the commercial operations of which commenced, whether by such person or partnership or any other person or partnership, on a date which falls within the period of thirty six months immediately preceding the first day of that relevant quarter.

For the purposes of the proviso the expression "trade or business" in relation to any person or partnership shall not include any trade or business which deals in the wholesale or retail of any goods not manufactured or produced by such person or partnership.

(b) "turnover" in relation to any trade, business, profession or vocation and to any relevant quarter means ***<u>the total amount receivable, whether actually</u>***

> ***received or not, from every transaction entered into in that relevant quarter*** *in the course of such trade, business, profession or vocation carried on or exercised by such person or partnership"*

The above section defines the term 'relevant turnover' under the Act shall be the aggregate turnover of the entity for the specified quarter. Further, section 2(3)(b) states the 'turnover' in relation to any entity for the specified quarter shall include the total amount receivable; this includes the amount received or receivable in future for any transaction which was entered in the specified quarter by the entity. Therefore, it is apparent that the term 'turnover' shall include both the amount received and receivables for the relevant quarter.

The said interpretation for the term 'turnover' has not been disputed by either of the parties.

When considering the facts and circumstances of the case, it can be understood that the services provided by the Respondent is only in terms of the cutting and polishing of the rough diamonds imported. Based on this transaction, the Respondent earns a sum for its services in foreign exchange which is not the value of the diamonds. Accordingly, the turnover of the Respondent shall include the aggregate of the sum received or receivable by the Respondent for the services provided by them to its customers, and not the value of the diamond as a whole, or the value declared during the importing and exporting process of the said diamond for the customs purposes.

Further, the Appellant's arguments in relation to the value of the diamond being included in the Custom Declaration (CUSDEC) cannot be accepted since the purposes of the said statute are distinct. The CUSDEC shall include the exact value of the diamond due to the financial value of the product, the cross border transaction, physical possession and much more crucial components associated with the cross border transaction. However, the ESC is charged for a different purpose by the government on the aggregate turnover of the business. Further, unless the said diamond is owned by the business, the value of the diamond cannot be considered in calculating the ESC.

Moreover, for the determination of the value addition for the purpose of VAT, it is essential that Respondent declaring the initial value. However, that does not make the value of the diamonds, a part of its turnover.

For instance, if we consider the services rendered by a Launderette, they are only charged for the services of cleaning the clothes provided to them by their customers and they cannot be charged for the value of the clothes, since the clothes are given back to the customer after the said service is made. Therefore, the turnover of the said Launderette shall be confined to the fee received by them for their services of cleaning the said clothes and not the value of the clothes. Similarly in the current situation, the Respondent is acting merely as a custodian while the rough diamonds are imported for their services of polishing them until it is sent back to the original owner of the diamond with the diamond residues.

Furthermore, in interpreting taxation statute, it is the duty of the court to give effect to the intention of the legislature when the legislature had adopted clear and concise wording. Accordingly, the judiciary is not authorized to import a novel interpretation when the statute itself has provided for the definition of specified terms.

This position can be seen in *N.S. Bindra* '*Interpretation of Statutes'*, (13th edn, Lexis Nexis, pg 855-856) in the following manner;

> *"The court must look squarely at the words of the statute and interpret them. It must interpret a taxing statute in the light of what is clearly expressed; it cannot imply anything which is not expressed; it cannot import provisions in the statute so as to supply any assumed deficiency. There is no equity about a tax and there is no presumption as to tax. Nothing is to be read in and nothing is to be implied."*
>
> *While equitable considerations are of no avail in the construction of taxing statutes, a proper balance must be struck between the essential needs for Revenue of a modern. welfare state on the one hand and the desirability that the citizen must know his liability clearly before he can be called upon to contribute to the Revenue on the other. "*

Therefore, it is my view that the aggregate turnover of the Respondent should be calculated on the total amount received/receivable by an entity in the relevant quarter. Accordingly, in the present circumstance, the Respondent providing the services of cutting and polishing rough diamond, shall only be required to calculate the ESC on the annual turnover received for their services of cutting and polishing rough diamonds and not the value of the diamond as a whole. Furthermore, the value of the said diamonds would never be a part of their turnover, since they are neither purchased nor sold by them.

Hence, I answer the Question of law No. IV in favour of the Respondent.

In view of the conclusion reached in respect of Question of Law No. IV, this Court hold that the TAC has not erred in law in determining that the Respondent is required to calculate the ESC on the value of the services issued by them. Therefore, the determination of the TAC dated 26th of August 2014 shall sustain.

In light of the foregoing conclusion, this court observes that the remaining Questions of law raised by the Appellant will not arise and need not be answered.

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 – Need not be addressed

Question of law II – Need not be addressed

Question of law III – Need not be addressed

Question of law IV – Should be based on the amount received by the Respondent for cutting and polishing the diamonds.

The determination of the TAC dated 26th of August 2014 shall sustain, and the Notice of Assessment dated 7th of March 2008 issued by the Senior Assessor of the Economic Service Charge branch of the Department of Inland Revenue is null and void.

The appeal is dismissed.

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

Judge of the Court of Appeal

Annalingam Premashanker J.

I agree

Judge of the Court of Appeal