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

In the matter of a "Case Stated" under Reference No. TAC/IT/008/2018 by the Tax Appeals Commission under Section 11A of the Tax Appeals Commission Act, No. 23 of 2011

Court of Appeal Application No: CA/Tax/07/2022
Tax Appeal Commission No: TAC/IT/008/2018

Ceylinco Leasing Corporation Ltd,
No. 122, Kesbewa Road,
Divulapitiya,
Boralesgamuwa.

APPELLANT

-Vs-

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

RESPONDENT

Before: S. U. B. Karalliyadde, J.

Mayadunne Corea, J.

Counsel: F. N. Goonewardena with Prashanthi Vignanantha for the Appellant.

Ms. Zuri Zain, DSG for the Respondent.

Written submissions tendered on:

On 30.10.2022 and 07.03.2024 by the Appellant.

On 31.03.2023 and 10.05.2024 by the Respondent.

Argued on: 31.01.2024

Decided on: 31.07.2024

S. U. B. Karalliyadde, J.

This case has been transmitted to this Court in terms of Section 170 of the Inland Revenue Act, No.10 of 2006 seeking for an opinion to the questions of law mentioned in the "case stated" formulated the Tax Appeals Commission established under the Tax Appeals Commission Act, No.23 of 2011.

The Ceylinco Leasing Corporation Ltd, the Appellant is a limited liability Company incorporated in Sri Lanka engaged in the business of leasing, hire purchase and earning rental income. The Appellant submitted its return of income for the year of assessment 2012/2013 and by letter date 23.11.2015[1] the Deputy Commissioner of the Department of Inland Revenue informed the Appellant that the return of income was rejected for the reason that the Appellant remains the owner of the Staana Vaasi Portfolio despite CLC Asset Management Ltd enjoy the economic benefits accrued on the lease portfolio due to a Participatory Agreement and considering the fact that the Appellant has declared lease rentals arising from Staana Vaasi Portfolio in the VAT Return. Thereafter, the Notice of Assessment dated 27.11.2015[2] was issued to the Appellant.

By letter dated 23.12.2015, the Appellant made an appeal to the Commissioner General of Inland Revenue (the Respondent) against the said assessment. The Respondent made

[1] at page 338 L of the appeal brief.

[2] at page 338 J of the appeal brief.

his determination confirming the said assessment and communicated the same to the Appellant by letter dated 15.12.2017.[3] Being aggrieved by the said determination, the Appellant appealed to the Tax Appeals Commission (the TAC) by the Petition dated 14.03.2018. After hearing the appeal, the TAC confirming the determination made by the Respondent dismissed the appeal and the Appellant was informed the decision of the TAC by the letter dated 08.12.2021.[4]

Accordingly, with the view of forming an opinion, in terms of Section 170(6) of the Act No.10 of 2006, this Court considered the questions of law raised in the "case stated". The questions of law to which the opinion is sought are as follows:

1. Has the Tax Appeals Commission erred in failing to consider that the Appellant has derecognised its entitlements to the income of the Sthaana Vaasi Financing Portfolio (SVF Portfolio) in accordance with Sri Lanka Accounting Standards as more fully described in Item 1.10.2 if the Accounting Policies of the Financial Statements of the Appellant for the year ended 31st March 2013?

2. Did the Tax Appeals Commission err in law in failing to consider as to whether there had been a sale as contemplated by law of the income entitlement of the SVF Portfolio from the Appellant to CLC Asset Management (Pvt) Ltd?

3. Did the Tax Appeals Commission err in law in determining that the entitlement to the income of the SVF Portfolio remained with the Appellant for the purpose

[3] at page 338 d of the appeal brief.

[4] at page 432 of the appeal brief.

of determining the profit and income of the Appellant for the year of assessment 2012/2013?

4. **Was the Commissioner General of Inland Revenue estopped from determining the appeal against the Appellant on the basis of the determination for the year of assessment 2013/2014 on the identical issue being determined in favour of the Appellant?**
5. **Has the Tax Appeals Commission erred in law in failing to consider whether any determination which results in the entitlement to the SVF Portfolio remaining with the Appellant would give rise to double taxation on the income since such income was also recognised by CLC Asset Management (Pvt) Ltd?**

The questions of law are addressed by this Court as follows.

1. **Has the Tax Appeals Commission erred in failing to consider that the Appellant has derecognised its entitlements to the income of the Sthaana Vaasi Financing Portfolio (SVF Portfolio) in accordance with Sri Lanka Accounting Standards as more fully described in Item 1.10.2 of the Accounting Policies of the Financial Statements of the Appellant for the year ended 31st March 2013?**

The Appellant submits that it has derecognized its entitlements to the income of the Sthaana Vaasi Financing Portfolio (SVF Portfolio) in accordance with the Sri Lanka Accounting Standards as described in Item 1.10.2[5] of the Accounting Policies of the

[5] at page 261 of the appeal brief.

Financial Statements of the Appellant for the financial year ended 31st March 2013 and considered the SVF Portfolios as "Finance Leasing Facilities" since the lands and buildings were sold by the Appellant Company on finance lease terms. As provided, the legal definition of a lease is "a written agreement in which the owner of property (either real estate or some object like an automobile) allows to use of the property for a specified period of time (term) for specific periodic payments (rent), and other conditions".

However, the Tax Appeal Commission (the "TAC") has held that the SVF Portfolios are not "Finance Leasing Facilities", but Operating Lease Stock/Facilities granted by the Appellant on the basis that the Appellant retains the ownership of the assets. Also, even if the SVF Portfolio is considered as Finance Leasing Facilities, the lease rentals collected by the lessor (Appellant) should be regarded as income according to the accounting treatment for finance lease facilities. The position of the Respondent is that the Appellant (lessor) shall recognize assets held under a finance lease in their statement of financial position and present them as receivables at an amount equal to the net investment in the lease. As per the tax treatment for Finance Lease Facilities, even in a finance leasing portfolio, the lease rentals are treated as part and parcel of the profits and income of the lessor, and liable for both VAT and Tax purposes of the lessor. This Court is in agreement with the said view of the Respondent that even if the SVF Portfolio is to be considered as a Finance Lease Facility, the lease rentals collected by the lessor is regarded as income of the Appellant.

In terms of Sri Lankan Accounting Standard "LKAS 32 – Financial Instruments – Presentation", a financial asset is defined as an asset, *inter alia,* to receive cash or another financial asset from another entity. The Appellant contends that the SVF Portfolio has been derecognized as a financial asset in the Statement of Financial Position[6] for the year of assessment 2012/2013. However, this Court agrees with the determination of the Respondent and the determination of the TAC for the reasons that even though the assets have been derecognized in the Statement of Financial Position, the Appellant being the lessor of the properties under lease agreements, has retained the ownership of the assets while the lessees of such properties are in possession.

E. Gooneratne states, in his work titled *Income Tax in Sri Lanka*[7]: that

> *"Evidence that a particular practice has been followed in preparing the accounts of a trader has no value if that practice conflicts with any of the provisions in the taxing statute."*

Even if the Appellant has derecognized the SVF Portfolio in its financial statements, the Appellant had continued to have the ownership of the assets and all the risks are still vested on the Appellant. Therefore, the Court is of the view that the Assessor is justifiable in attributing the income accrued by the SVF Portfolio to the Appellant and accordingly, the TAC also did not err in affirming the decision of the CGIR on the

[6] at page 261 of the appeal brief.

[7] M. Weerasooriya and E. Gooneratne, Income Tax in Sri Lanka, Second Edition, 2009. at p.522

above matter. The Court answer the first question of law in the negative and favour of the Respondent.

2. Did the Tax Appeals Commission err in law in failing to consider as to whether there had been a sale as contemplated by law of the income entitlement of the SVF Portfolio from the Appellant to CLC Asset Management (Pvt) Ltd?

The contention of the Appellant is that income entitlement of the SVF Portfolio has already been transferred to CLC Asset Management by the Participation Agreement and submitted that in terms of Clause 1(a)(i) of the Participation Agreement, the sales agreement has been concluded. Clause 1(a)(i) of the Participation Agreement reads as follows.

> *Clause 1(a)(i) "The Seller does hereby sell to the Participant a 100% entitlement (each, a "Participation") in the Sthana Vaasi Financing (as hereinafter defined) which shall for the avoidance of doubt include the amounts due or to become due thereunder, for the purchase price therefore (the "Purchase Price"), and such other details as the Seller deems appropriate."*

The position of the Appellant is that in terms of the above Clause, 100% income entitlement of the SVF Portfolio has been sold by the Appellant and, hence there has been a sale effected under the Participation Agreement, any income under SVF portfolio should not be considered as an income of the Appellant. The TAC and the

Respondent held a contrary view to that the Appellant has entered into a financing arrangement to obtain funds from CLC Asset Management and the rentals collected from obligators has been utilized to pay back the liability the Appellant had towards CLC Asset Management. As per Clause 5 (Seller's rights and duties) and Schedule No. 2 (Administration and Management) of the Agreement, the Appellant Company has all the rights and authority in respect of any participation (the SVF Portfolio) and as per Clause 3, the right to collection of due rentals from obligators also kept with the Appellant. Further, as per Clause 7 of the Agreement in sub paragraph (a) reads as; *"The participant shall be made all payments in Sri Lankan Rupees in immediately available funds, to such account of the seller in such location as the seller may designate, without deduction, setoff or counterclaim."*. Therefore, it has been held that the Appellant had obtained funds from CLC Asset Management and settled the funds granted with the collected rentals from Obligators and Guarantors and hence, the Appellant has continued to be benefitted from the income from the SVF Portfolio.

In *Union Planters National Bank of Memphis v. United States*[8], the Sixth Circuit it is stated that,

> *"In cases where the legal characterization of economic facts is decisive, the principle is well established that the tax consequences should be determined by*

[8] 426 F.2d 115 (6th Cir. 1970)

the economic substance of the transaction, not the labels put on it for property law (or tax avoidance) purposes."

When considering the above stated provisions in the Participation Agreement, it is clear that the TAC has carefully considered and evaluated the evidence before it when arriving at its decision. Therefore, this Court agrees with the conclusion of the TAC that there has been no sale of the SVF Portfolio from the Appellant to CLC Asset Management (Pvt) Ltd for the reason that the Appellant has continued to be benefitted from SVF portfolio and utilized the collected rentals to set off the funds that has been granted by CLC Asset Management.

Under the above said circumstances, my opinion is that the TAC also did not err in affirming the decision of the CGIR on the above matter. I answer the second question of law in the negative and in favour of the Respondent.

3. Did the Tax Appeals Commission err in law in determining that the entitlement to the income of the SVF Portfolio remained with the Appellant for the purpose of determining the profit and income of the Appellant for the year of assessment 2012/2013?

This question of law considers whether the income of the SVF Portfolio could be considered as profit and income of the Appellant. The Appellant argues that, no profit or income was generated after the right to receive economic benefits from the Staana Vaasi Portfolio was sold to the CLC Assets Management and for the reason that the

Appellant carried on the business does not amount him to be liable to pay income tax under Section 3 of the Act as the Appellant is not entitled on such income. The TAC in its determination considering Section 3 of the Act, has concluded that the Appellant is the one who carries on the business and the relationship with the CLC Assets Management is a financial arrangement and therefore the Appellant is liable to pay income tax on the lease rentals collected by them.

Now the question to be considered is whether the lease rentals collected by the Appellant could be considered as "profits and income" earned by the Appellant from the business within the ambit of Section 3 (a) of the Act. Section 3 (a) reads thus,

> *3. For the purpose of this Act, "profits and income" or "profits" or "income" means*
>
> *c) the profits from any trade, business, profession or vocation for however short a period carried on or exercised;*

The Stana Vaasi Portforlio is a portfolio of land and buildings sold by the Appellant on finance lease terms where customers buy the properties by the payment of monthly lease rentals and final payments to transfer the ownership of the property at the end of the lease period. The Appellant by the Participation Agreement (Clause 1(a)(i)) had agreed to sell 100% entitlement of the SVF Portfolio to CLC Assets Management, however, the Appellant remains the owner of the SVF Portfolio. Moreover, in terms of the Participation Agreement, "Sthaana Vaasi Portfolio also entitles the Seller to receive from Obligators the lease rentals and/or rents relating to the properties until the

properties are transferred to the Obligators" and the right to collect the lease rentals from the Obligators or Guarantors lies with the Appellant. The Appellant had paid back the lease rentals so collected to settle the funds granted by the CLC Assets Management.

TAC in its determination has observed as follows, "*Accordingly, it can be seen that the Contracts of the Leases between the Appellant and the respective lessees exist without any change. Therefore, the Appellant was bound to adhere to the respective agreements made with the lessees of the assets which were still under lease agreements. Therefore, it is clear that, the Appellant being the lessor of the properties under lease agreements, should retain the ownership of the assets while the lessees of such properties are in the possession of such assets. Under the lease agreements, the authority to collect the lease rentals from the customers of SVF Portfolio imposed on the Appellant as the lessor. The Appellant also was under obligation to transfer of the ownership of immovable property to the obligator after specified periods of time, subject to the full payment of lease rentals. Under these circumstances, the Appellant Company is the person who carried on the business. It is obvious that, under the provisions of the Inland Revenue Act No. 10 of 2006 as amended, the income tax liability is on the person who carries on the business.*"

In *Sri Lankan Airlines Limited vs. The Commissioner General of Inland Revenue*[9] Dr. Ruwan Fernando, J. observed that, "*...it is necessary for the assessor to ascertain and*

[9] CA/TAX/0002/2010 CA Minutes dated 28.02.2023.

identify the source of income for the purposes of determining the profits and income chargeable with income tax, and the rates applicable to such source of income."

As mentioned hereinbefore the TAC has correctly identified the sources of income of the Appellant for the purpose of determining the profit. Even though the right to entitlement for the economic benefits derived by the SVF Portfolio has been sold to CLC Assets Management by the participation agreement, the Appellant remains the legal owner of the SVF Portfolio. Therefore, the lease rentals collected by the Appellant become part and parcel of the profit of the Appellant.

Hence, the Court is of the opinion the view that the Assessor is correct in attributing the income accrued by the SVF Portfolio to the Appellant and accordingly, the TAC also did not err in affirming the decision of the CGIR on the above matter. The Court answer the third question of law in the negative and in favour of the Respondent.

4. Was the Commissioner General of Inland Revenue estopped from determining the appeal against the Appellant on the basis of the determination for the year of assessment 2013/2014 on the identical issue being determined in favour of the Appellant?

The Respondent has determined (the "Annexture") in favour of the Appellant on the issue whether the rentals collected from Obligators and Guarantors under SVF Portfolio for the 2014/2015 financial year and held that the Appellant Company has transferred

all of its entitlements including risks and rewards (economic benefits) of ownership to CLC Asset Management with effect from the date of the Participation Agreement. Further, the Respondent in response to the contention of the Appellant the Commissioner General of Inland Revenue binds by his previous decisions, argues that the annual income tax and the decision given in a particular year of assessment does not have a binding effect on another year of assessment. The determination of TAC in the subsequent case bearing No. TAC/IT/058/2019 filed by the Appellant in this case citing the case of *Abdul Gaffor Vs CIT*[10], the TAC and the Respondent has concluded that in matters of recurring annual tax, a decision of the Appeal with regard to one year cannot operate as *res judicata* in respect of an assessment of another year and refused to accept the contention of the Appellant.

It is the view of this Court that the general rule that has been applied over many years is that the principle of estoppel does not apply in respect of an identical issue in different financial years and the doctrine of *res judicata* is not applicable in tax matters. The principle underlying is that no one should present same set of facts differently to reach different conclusions in different financial years. The Appellant relying on the decision of *Radhasoami Satsang Vs Commissioner of Inland Revenue*[11] argues in the Written Submissions dated 30.10.2022 that the subsequent determination of the CGIR for the year of assessment 2014/2015 estoppes the CGIR from determining the matter

[10] 3CT 96.

[11] 1991 Indlaw SC 948

differently for the financial year 2012/2013. In *Radhasoami Satsang* case (Supra), the Supreme Court observed that,

> *"We are aware of the fact that strictly speaking res judicata does not apply to income tax proceedings. Again, each assessment year being a unit, what is decided in one year may not apply in the following year but where a fundamental aspect permeating through the different assessment years has been found as a fact one way or the other and parties have allowed that position to be sustained by not challenging the order, it would not be at all appropriate to allow the position to be changed in a subsequent year."*

However, in *Instalment Supply (Pvt.) Ltd*[12] the Supreme Court of India held that in tax matters there is no question of *res judicata* because each year's assessment is final only for that year and does not apply later years. Hence, this Court does not accept the position that the determination of the Respondent for the subsequent year estoppes the Respondent from determining the case related to this Appeal in contrary and does not create a retrospective effect of a pre-determined matter.

For the reasons enumerated above, the decision of the Tax Appeals Commission to confirm the determination made by the Respondent and to dismiss the appeal of the Appellant is according to law.

[12] AIR 1962 SC 53

Therefore, the Court answer the fourth question of law in the negative and in favour of the Respondent.

5. Has the Tax Appeals Commission erred in law in failing to consider whether any determination which results in the entitlement to the SVF Portfolio remaining with the Appellant would give rise to double taxation on the income since such income was also recognised by CLC Asset Management (Pvt) Ltd?

The Appellant has submitted in its Written Submissions that the determination of the Respondent would give rise to double taxation of the income since CLC Asset Management would have recognized the income from SVF Portfolio in its financial statements and would have duly paid tax on such lease rentals collected by the Appellant on behalf of the CLC Asset Management. Even though double taxation is a fundamental principle in tax law, the Appellant has neither raised that issue before the Respondent or the TAC nor established his position by providing evidence. In terms of TAC Act, the Court of Appeal has the power to determine questions of law before it, and the substantial matters should be decided by the CGIR and TAC. In the case of *Cargills Agrifoods Ltd Vs Commissioner General of Inland Revenue*[13] Samarakoon, J. observed that,

[13] CA/Tax/0006/2013 CA Minutes dated 28.02.2023

"The section 7(1) of the Tax Appeal Commission Act in two places, speaks about the "determination" of the appeal. Hence, an appeal has to be "determined" by the Tax Appeals Commission, which means the determination of the ***substantial question****, with regard to the tax, etc."*

Samarakoon, J. further stated that,

"What shall the Court of Appeal do when it receives such a case stated? Section 11A. (6) says,

"11A. (6) Any two or more Judges of the Court of Appeal may hear and determine ***any question of law*** *arising on the stated case and may in accordance with the decision of the Court upon such question, confirm, reduce, increase or annul the assessment determined by the Commission, or may remit the case to the Commission with the opinion of the Court, thereon. Where a case is so remitted by the Court, the Commission shall revise the assessment in accordance with the opinion of the Court".*

Hence, any two or more Judges of the Court of Appeal may,

(i) ***determine any question of law arising on the stated case****, it does not say may determine the "determination" of the Commission.*

(ii) confirm, reduce, increase or annul the assessment determined by the Commission,

(iii) or may remit the case to the Commission with the opinion of the Court, thereon.

This may or may not be on the "determination" of the Commission, because the term "thereon" refers to "any question of law arising on the stated case".

(a) there can be a case stated on a question of law other than the determination of the Commission on tax,

(b) the Court has power to remit the case to the Commission, with its opinion on the question of law so arose and

(c) the Commission shall, on receiving such an opinion of the Court, revise the assessment of the assessor."

Further, in the case of *Commissioner General of Inland Revenue vs Janashakthi Insurance Company Limited*[14], Malalgoda, J. observed that,

"As already observed by me, there are specific provisions in the TAC Act which governs the process before the TAC as well as a case stated before the Court of Appeal. In the said process, much importance has been given for identification of the questions of law that is to be considered in the case stated by making provisions for the TAC to reconsider the question that are submitted by the

[14] SC Appeal No. 114/2019, SC Minutes dated 26.06.2020

Appellant and two Judges to consider them once again and referred it back to TAC to reconsider them."

To determine whether the determination of the Respondent and TAC amounts to double taxation, the Appellant should have produced evidence before the Respondent and the burden of proof lies with the Appellant. This Court is not supposed to consider the questions of facts but not questions of law. Since the Appellant has failed to raise this matter before the Respondent and produce evidence to establish its position there is no question of law for this Court to consider in terms of TAC Act, and hence I answer the fifth question of law in the negative and in favour of the Respondent.

For the reasons, enumerated in this judgment, I hold that the decision of the Tax Appeals Commission to affirm the determination of the Respondent and dismiss the appeal is according to law.

Conclusion & Opinion of the Court

Under such circumstances, I answer the questions of law in favour of the Respondent and against the Appellant as follows:

1. No

2. No

3. No

4. No

5. No

For those reasons mentioned in this judgment and subject to our observations, I affirm the determination made by the Tax Appeals Commission dated 08.12.2021 and dismiss the Appeal. The Registrar of this Court is directed to send a certified copy of this judgment to the Tax Appeals Commission forthwith.

JUDGE OF THE COURT OF APPEAL

Mayadunne Corea, J.

I agree.

JUDGE OF THE COURT OF APPEAL