

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/007/2011 by the Tax Appeals Commission under Section 170 of the Inland Revenue Act No: 10 of 2006 as amended.

Case No: CA/TAX/03/2013

CEI Plastics Limited,

TAC Case No. TAC/IT/007/2011

108 W.A.D. Ramanayake Mawatha,

Colombo 02.

Appellant

Vs.

Commissioner General of Inland Revenue

Department of Inland Revenue,

Sir Chittampalam A.Gardiner Mawatha,

Colombo 02.

Respondent

Before: Janak De Silva J.

Achala Wengappuli J.

Counsel:

F.N. Goonewardena for the Appellant

Anusha Fernando DSG for the Respondent

Written Submissions tendered on:

Appellant on 03.07.2018

Respondent on 03.07.2018

Argued on: 10.07.2018

Decided on: 01.02.2019

Janak De Silva J.

The Appellant is a limited liability company involved in the business of manufacturing and selling plastic items and it also has a substantial portfolio of shares in public listed companies in Sri Lanka. The Appellant with other related persons is the single largest shareholder in John keels Holdings PLC a public listed company.

The dispute relates to the year of assessment 2007/2008 during which the Appellant had an interest expense of Rs. 271,022,142/= which it had deducted against its profits for the purpose of calculating its income tax liability.

The assessor refused the deduction of part of the aforesaid interest expense amounting to Rs. 167,075,212/= on the basis that such interest expense related to share trading activities of the Appellant and an assessment dated 26th March 2010 was issued on that basis and received by the Appellant on 7th April 2010.

The Appellant appealed against the assessment by letter dated 22nd April 2010 and the appeal was duly acknowledged by the Respondent by letter dated 25th May 2010. The Respondent heard the appeal and confirmed the assessment against which the Appellant preferred an appeal to the Tax Appeals Commission (TAC). The TAC dismissed the appeal. The Appellant made an application to the TAC to have a case stated to this Court.

The TAC has acting under section 170 of the Inland Revenue Act No. 10 of 2006 (Act) referred the following questions of law for the opinion of this Court:

- (1) Was the assessment for the year 2007/2008 dated 26th March 2010 issued against the Appellant time barred in terms of Section 163(5)(a) of the Inland Revenue Act, as applicable to such year of assessment?
- (2) Was the interest incurred by the Appellant to the value of Rs. 167,075,212/= deductible in determining the profits from trade of the Appellant for the year of assessment 2007/2008 in terms of Section 25 of the Act?

- (3) In the alternative, was the aforesaid interest incurred by the Appellant to the value of Rs. 167,075,212/= deductible in determining the assessable income of the Appellant for the year of assessment 2007/2008 in terms of Section 32(5)(a) of the Act?
- (4) Notwithstanding the above, was the basis used by the CGIR in arriving at the interest expenses attributable to the investment business of the Appellant erroneous in law?

Time Bar

The Appellant submits that the assessment for the year 2007/2008 dated 26th March 2010 issued against the Appellant is time barred in terms of Section 163(5)(a) of the Act. The TAC held it was not time barred. However, it appears that this matter was raised for the first time in the written submissions filed before the TAC. It was not raised before the Respondent or in the appeal addressed to the Respondent.

Therefore, I wish to address the objection raised by the Respondent that this is not an issue that could have been raised before the TAC.

The learned DSG submitted that the failure to comply with time limit constitutes a latent or contingent want of jurisdiction which must be raised at the very outset and the failure to do so can amount to a waiver or acquiescence on the other party. In support of this proposition the decision in *Perera v. Commissioner of National Housing* (77 N.L.R. 361) was cited where Tennakoon C.J. held (at page 366):

“Lack of competency in a Court is a circumstance that results in a judgment or order that is void. Lack of competency may arise in one of two ways. A Court may lack jurisdiction over the cause or matter or over the parties; **it may also lack competence because of failure to comply with such procedural requirements as are necessary for the exercise of power by the Court.** Both are jurisdictional defects; the first mentioned of these is commonly known in the law as a ' patent' or ' total' want of jurisdiction or a defectus jurisdictionis and **the second a ' latent' or ' contingent' want of jurisdiction or a defectus triationis.** Both classes of jurisdictional defect result in judgments or orders which are void. But an important difference must also be noted. In that class of case where the want

of jurisdiction is patent, no waiver of objection or acquiescence can cure the want of jurisdiction; the reason for this being that to permit parties by their conduct to confer jurisdiction on a tribunal which has none would be to admit a power in the parties to litigation to create new jurisdictions or to extend a jurisdiction beyond its existing limits, both of which are within the exclusive privilege of the legislature; the proceedings in cases within this category are non coram judice and the want of jurisdiction is incurable. **In the other class of case, where the want of jurisdiction is contingent only, the judgment or order of the Court will be void only against the party on whom it operates but acquiescence, waiver or inaction on the part of such person may estop him from making or attempting to establish by evidence, any averment to the effect that the Court was lacking in contingent jurisdiction.”** (emphasis added)

Having considered the relevant statutory provisions, I am in agreement with the position articulated by the learned DSG that the time bar in section 163(5) of the Act creates only a latent or contingent want of jurisdiction and that the Appellant has waived or acquiesced by failing to raise it at the very outset.

In any event, for the sake of completeness I am of the view that in the instant case there is no time bar for the reasons set out below.

The Appellant filed its income tax return for the year of assessment 2007/2008 on 30th September 2008 and states that it received an assessment issued by the Inland Revenue Department dated 26th March 2010 on 7th April 2010. The Appellant submits that the assessment should have been issued before 30 September 2009.

A similar issue arose some time ago when the amendment to the Act in 2009 was the subject matter in *Seylan Bank PLC. v. The Commissioner General of Inland Revenue* [CA(Tax) 23/2013, C.A.M. 23.05.2015]. In that case this Court held that irrespective of whether the assessee had to submit the tax return on or before the 30th September or 30th November 2009, the assessor can send the assessment to the assessee within two years immediately succeeding that year of assessment. The Court further considered the amendments made to section 163 of the Act by Act Nos. 22 of 2011, 18 of 2013 and 8 of 2014. It held that the two-year period given to the

assessor to send the assessment against the assessee was to start from the end of the year of assessment originally, which is the 31st of March, every year. This date (the starting day of the period) has been further pushed down to the thirtieth day of November of the immediately succeeding year of assessment by Act No. 22 of 2011. The Court also held that section 163(5) of the Act is a procedural law and that even if the amendment has retrospective effect, it applies, if the amendment is only on procedural law.

Two judges sitting together as a rule follow the decision of two judges. Where two judges sitting together find themselves unable to follow a decision of two judges, the practice in such cases is also to reserve the case for the decision of a fuller bench [*Walker Sons & Co. (UK) Ltd. v. Gunatilake and others* (1978-79-80) 1 Sri.L.R. 231]. In any event, I am of the view that the reasoning in *Seylan Bank PLC. v. The Commissioner General of Inland Revenue* (supra) is sound and compelling and sets out the correct position of the law.

Trade or Business

Section 3(a) of the Act as amended reads:

“for the purpose of this Act, “profits and income” or “profits” or “income” means –

- (a) The profits from any trade, business, profession or vocation for however short a period carried on or exercised;”

The Appellant submits that the profits from the share trading activities it engages would fall within the provisions of section 3(a) of the Act but that it is not a “trade or business” but is merely an “activity”. The Appellant then identifies this “activity” as an “investment business” as contemplated by section 3(a) of the Act. However, in the very next paragraph of its written submissions, the point is made that share trading does not amount to a business but it is simply an activity that an entity engages in. The Appellant further submits that when an entity is investing in shares it is conducting an investment business and that trading in shares forms part of such business but it is not the business itself. The learned DSG submitted that there is no coherence in the arguments sought to be made by the Appellant and that the distinction sought to be made by the Appellant is only one of nomenclature and devoid of any real substance.

In this context it is important to ascertain what is meant by "business" in section 3(a) of the Act.

In *B.P. Medonza v. The Commissioner of Inland Revenue* [(79) 1 N.L.R. 459] in deciding whether certain betting activities amounted to a business, Samarawickrema J. stated (at page 477):

"Where the evidentiary material discloses the facts which I have set out, it is not possible for this Court to hold that there is no evidence to support a finding that the assessee's betting activities amount to a business. In point of fact the evidence amply supports such a finding.

The order of the Board states: " The systematic and continuous way the assessee had taken bets, the time and labour he had put into them, the facilities he had built around himself to place these bets and deposit the winnings clearly indicate that betting was a vocation and his dominant intention was to gain money."

In the instant case, the Appellant had obtained separate bank facilities for the specific purpose of share trading and the shares so purchased were mortgaged as security. There had been repetitive share trading transactions which had been carried on systematically in an organized manner. These facts in my view establish that the share trading activity referred to by the Appellant constituted a "business" within the meaning of Section 3(a) of the Act.

The next issue to be determined is whether the Appellant conducted two separate and distinct businesses or not. The Appellant admits that it is also involved in the business of manufacturing and selling plastic items.

In this connection the decision in *The Ceylon Tea Propaganda Board v. Commissioner of Inland Revenue* (67 N.L.R. 1) is instructive. The question that arose there is whether the Tea Propaganda Board which is an institution established by the Tea Propaganda Ordinance (Cap. 169) is liable to be assessed for Income Tax in respect of certain moneys in the hands of the Board.

H.N.J. Fernando J. (as he was then) held (at page 5):

"No doubt the Board does carry on a business, namely that of tea propaganda, and may incidentally carry on some other business or some trade, and the proceeds of the duty

are received and utilised for the purpose of carrying on the business. But these proceeds are not properly profits from the business, because they are not earned or produced in the course of or as a result of the business which is carried on. They are in fact received from another source, in the same sense as would be the case if the trustees of a will are directed to make periodical payments to the Board or if the Government had vested land in the Board in order that it may receive an income in the form of rents. **If for instance a trading company holds land from which rent is derived and uses that rent for its trading purposes, the Ordinance does not regard that rent as profits from the trade;" (emphasis added)**

I hold that on the available facts, the Appellant conducted two separate and distinct businesses namely, business of manufacturing and selling plastic items and business of share trading.

Section 106(11) of the Act reads:

"Where any person carries on or exercises more than one trade, business, profession or vocation and the profits and income from such trade, business, profession or vocation are exempted from or chargeable with tax at different rates, such person shall maintain and prepare statements of accounts in a manner that the profits and income from each such activity, may be separately identified."

The Appellant submits that this section has no application to the instant case as the Appellant is not involved in two businesses which are subject to different tax rates. Reference was made to section 13(t) of the Act which exempts only profits from the trading of shares of public listed companies in respect of which a Share Transaction levy has been charged in terms of Section 7 of the Finance Act No. 5 of 2005. However, as the learned Deputy Solicitor General submitted the Appellants own admission at paragraph 2 of page 48 of the brief, that it has a substantial portfolio of shares in public listed companies in Sri Lanka and that the principal investment of the Appellant is in the shares of John Keels Holding PLC together with related persons denudes any validity to the submission of the Appellant. This position is further fortified by the fact that the Appellant had sold shares in listed companies and claimed tax exemption for profits earned from such share trading. Accordingly, in my view the Appellant was under a duty to maintain and

prepare statements of accounts in a manner that the profits and income from the business of manufacturing and selling plastic items and business of share trading, may be separately identified which the Appellant failed to do.

The Appellant sought to argue that section 106(11) of the Act is an administrative provision and does not provide a basis of deductibility of expenses for each line of business. It was further submitted that the income tax return of a tax payer is one composite return and therefore there is no basis for a separate computation of profits for each line of business unless there is specific provision to that effect in the Act. Accordingly, it was submitted that the relevant question is whether the interest incurred by the Appellant to the value of Rs. 167,075,212/= is deductible in determining the profits from trade of the Appellant for the year of assessment 2007/2008 in terms of Section 25 or 32(5)(a) of the Act? However, this submission disregards the fact that section 106(11) of the Act was included after the judgement of the Supreme Court in *Rodrigo v. The Commissioner General of Inland Revenue* [(2002) 1 Sri.L.R. 384] which dealt with a case where the facts established an indivisible business. I shall advert to the decision in *Rodrigo v. The Commissioner General of Inland Revenue* (supra) shortly.

Section 25(1)(f) of the Act

The Appellant submitted that it was entitled to deduct the interest incurred by the Appellant in relation to its share trading business to the value of Rs. 167,075,212/= in determining the profits from trade of the Appellant for the year of assessment 2007/2008 in terms of Section 25 of the Act.

In order to convince Court that this is the correct interpretation of the relevant statutory provision the Appellant sought to interpret the word “including” in section 25(1) of the Act so as to enlarge the meaning of the previous phrase so that along with the general statement that it is the expenses incurred in the production of the profits and income that is tax deductible, the items specified in the list in section 25(1) are also tax deductible. In support of this argument the Appellant cited *Maxwell on the Interpretation of Statutes* (12th edition; pages 207-271) and the decision in *Reynolds v. Commissioner of Income Tax for Trinidad and Tobago* [(1965) 3 All E.R. 901].

Before dealing with this issue in detail, I wish to point out that our courts have not uniformly given the word "including" an extended meaning as proposed by the Appellant and has instead on some occasions interpreted the word "includes" as the equivalent of "means". [*Commissioner of Income Tax v. Baddrawathie Fernando Charitable Trust* (63 N.L.R. 409), *The Ceylon Tea Propaganda Board v. The Commissioner of Income Tax* (67 N.L.R. 1)].

In *The Commissioner of Inland Revenue v. A.L.J. Croos Raj Chandra* (67 N.L.R. 174 at 178) Tambiah J. after an exhaustive analysis stated:

"The word 'include' is generally used in interpretation clauses in order to enlarge the meaning of words or phrases occurring in the body of the statute and when so used these words or phrases must be construed as comprehending, not only such things as they signify according to their natural import, but also those things which the interpretation clause declares that they shall include. But the word ' includes ' is susceptible of another construction, which may become imperative, if the context of the Act is sufficient to show that it was not merely employed for the purpose of adding to the natural significance of the words or expressions defined. It may be equivalent to ' mean and include' and in that case it may afford an exhaustive explanation of the meaning which, for the purpose of the Act, must invariably be attached to these words or expressions.

A careful perusal of section 2 of the Income Tax Ordinance shows that there is a clear cut scheme which underlies the definitions and that there is no haphazard arrangement or lack of uniformity in which the term " includes " is used. In this section, there are some terms defined by the use of the word " means ". In such cases, it is meant to be an exhaustive definition. Examples of such words are "active partner", "representative", "banker", etc. The word " includes " is used in some definitions as the equivalent of means but, in such cases, it is significant that the word that precedes the word " includes " is also placed after the word " includes ". Thus, for example, the word " receiver " is defined as follows: " Receiver includes any receiver, or liquidator, etc." The word " trade " is defined

as follows: " Trade includes trade and manufacture, etc." The word " trustee " is defined as follows: "Trustee includes any trustee, guardian, curator, etc."

When there are words or phrases preceding the word " includes " and the same words or phrases are placed immediately after it, it becomes necessary, in the context, to construe the word " includes " as equivalent of " means and includes ".

Under the third category the function of the word " includes " is merely enumerative. In such cases, the term is placed preceding the word " includes " and is followed by a number of other terms which, in common parlance, may not connote the term which precedes the word " includes". Thus, the word " business" is defined as " Business includes agricultural undertakings ". In common parlance, agricultural undertakings will not be construed as business. It is in this sense that the phrase " charitable purposes " is to be construed."

Accordingly, the word "includes" can have different meanings in the context in which it is used. Section 25(1)(f) of the Act reads:

"25(1) Subject to the provisions of subsections (2) and (4), there shall be deducted for the purpose of ascertaining the profits or income of any person from any source, all outgoings and expenses incurred by such person from any source, **all outgoings and expenses incurred by such person in the production thereof**, including-

...

(f) interest paid or payable by such person" (emphasis added)

In *ICICI Bank Limited v. The Commissioner General of Inland Revenue* [C.A. (Tax) 28/2013; C.A.M. 16.07.2015] Dehideniya J. held (at page 8) that the phrase "all outgoings and expenses incurred by such person in the production thereof" means the outgoings and expenses incurred for the purpose of generating the taxable income and it is the one that can be deducted and that the word "thereof" referred to the income generated by expending the said outgoings and the expenses. Such an interpretive approach is consistent with the approach the Supreme Court took

in *Rodrigo v. The Commissioner General of Inland Revenue* (supra) where Bandaranayake J. (as she was then) held that Sections 23 (1) and 24 of the Inland Revenue Act No. 38 of 2000 have to be read together as both provisions apply to the deducibility from the income and that taking both these sections together in their literal context, it appears that the meaning of words in section 23 (1) is restricted by the words given in section 24 (1) (g) of the Act. Bandaranayake J. further held (at page 394) that if any part of the expenses could be clearly identified as having been expended for the purpose of deriving money not being profits or income liable to tax, such amount could not be deducted in terms of section 24 (1) (g).

Sections 23(1) and 24(1)(g) of the Inland Revenue Act No. 38 of 2000 corresponds to sections 25(1) and 26(1)(g) of the Act and it is a trite rule of interpretation that the interpretation given by courts to similar words in the previous act is applicable when the same words in the new act is interpreted. Accordingly, it is not possible to give the word “includes” in section 25(1) of the Act an extended meaning in the context in which it is used and I hold that the interest incurred by the Appellant to the value of Rs. 167,075,212/= in relation to its business of share trading is not deductible for the purpose of ascertaining the profits or income of the Appellant from the profits of its other business of manufacturing and selling plastic items.

Section 32(5)(a) of the Act

The Appellant submitted that in the alternative, the aforesaid interest incurred by the Appellant to the value of Rs. 167,075,212/= is deductible in determining the assessable income of the Appellant for the year of assessment 2007/2008 in terms of Section 32(5)(a) of the Act.

Section 32(5)(a) of the Act reads:

“There shall be deducted from the total statutory income of a person for any year of assessment -

(a) sums paid by such person for any year of assessment by way of annuity, ground rent, royalty or interest not deductible under section 25. For the purposes of this

paragraph interest does not include the excess referred to in paragraph (x) of subsection (1) of section 26..."

I am unable to accept this submission for several reasons.

Firstly, section 32(5)(a) of the Act applies only where the interest is not deductible under section 25 of the Act. However, in the instant case the appellant is prevented from deducting the interest in view of section 26(1)(g) of the Act.

Secondly, section 32(5)(a) of the Act states that for the purposes of this paragraph the term "interest" means any interest paid on a loan the proceeds of which are utilized-

- (i) for the construction or purchase of any building or for the purchase of any site for the construction of any building;
- (ii) in any trade, business, profession or vocation carried on or exercised by him;

The claim of the Appellant does not come within this meaning.

Thirdly, section 32(5)(a) of the Act states that no deduction shall be allowed in respect of any such sum paid, unless the Assessor is satisfied that the recipient of such payment has issued a valid receipt for such payment, containing name, address and the income tax file number (if any) of such person in Sri Lanka or that the tax has been deducted under this Act before or at the time such payment is made. The available documentation does not show that the Appellant did raise the applicability of section 32(5)(a) of the Act either before the Assessor or the Respondent. Accordingly, I hold that it is not a matter that can be gone into by this Court as a question of law.

Fourthly, in any event section 32(5)(a) of the Act specifies several conditions that have to be met before its application and most of them deal with factual matters. The available documentation does not show that the Appellant did raise the applicability of section 32(5)(a) of the Act either before the Assessor or the Respondent. Accordingly, I hold that it is not a matter that can be gone into by this Court as a question of law.

For the foregoing reasons, Court answers the questions of law preferred by the TAC as follows:

- (1) Was the assessment for the year 2007/2008 dated 26th March 2010 issued against the Appellant time barred in terms of Section 163(5)(a) of the Inland Revenue Act, as applicable to such year of assessment? **This is not a matter that could have been raised before the TAC as it was not raised at the very outset. However, in any event, the assessment for the year 2007/2008 dated 26th March 2010 issued against the Appellant is not time barred.**
- (2) Was the interest incurred by the Appellant to the value of Rs. 167,075,212/= deductible in determining the profits from trade of the Appellant for the year of assessment 2007/2008 in terms of Section 25 of the Act? **No.**
- (3) In the alternative, was the aforesaid interest incurred by the Appellant to the value of Rs. 167,075,212/= deductible in determining the assessable income of the Appellant for the year of assessment 2007/2008 in terms of Section 32(5)(a) of the Act? **No.**
- (4) Notwithstanding the above, was the basis used by the CGIR in arriving at the interest expenses attributable to the investment business of the Appellant erroneous in law? **No.**

Accordingly, subject to the answers provided above, we confirm the determination made by the TAC.

The Registrar of the Court is directed to send a certified copy of this determination to the TAC.

Judge of the Court of Appeal

Achala Wengappuli J.

I agree.

Judge of the Court of Appeal