

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

*In the matter of a case stated for the
opinion of the Court of Appeal under
section 11 A of the Tax Appeals
Commission Act No. 23 of 2011 as
amended by Act No. 20 of 2013.*

CA (Tax) Appeal No. 10/ 2014

C A (Tax) Appeal No. 13 / 2014

The Commissioner General of
Inland Revenue

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

APPELLANT

-Vs-

Seylan Development P L C
90 A,
Level 15,
Ceylinco Seylan Tower,
Galle Road,
Colombo 03.

RESPONDENT

Before: **A H M D Nawaz J**

P Padman Surasena J

Counsel: Priyantha Nawana, SDSG for the Appellant.

F N Gunawardana for the Respondent.

Argued on : 2016 - 10 - 19

 2016 – 10 - 25

Decided on : 2017 – 04 - 06

JUDGMENT

P Padman Surasena J

When these cases were taken up for argument on 2016-10-19 learned counsel for both parties agreed that the issues to be decided by this court in respect of both the above numbered cases namely, C A (Tax) Appeal No. 10/ 2014 and C A (Tax) Appeal No. 13/ 2014, are the same.

They also agreed that C A (Tax) Appeal No. 10 / 2014, is in respect of the tax chargeable for the year of assessment 2008/2009 and C A (Tax) Appeal No. 13 / 2014 is in respect of the tax chargeable for the year of assessment 2005/2006 and 2006/2007. That being the only difference between the above two cases, learned counsel for both parties agreed that it would suffice for this Court to pronounce one judgment in respect of both the above cases. Hence this judgment must apply to both the cases referred to above.

The question of law that has been formulated for the opinion of this Court by the Appellant in terms of section 11 A of the Tax Appeals Commission Act as amended by Act No. 20 of 2013 and Act No. 23 of 2011, is as follows.

"Has the Tax Appeals Commission erred in interpreting the section 32(5) (b) of the Inland Revenue Act No. 10 of 2006 which says "the amount of a loss incurred by such person in any trade business profession or vocation which if it had been a profit would have been assessable under this Act, including any such loss brought forward from a previous year..."

The Respondent in the year 1993 had entered into the agreement (marked **R 1**) with the Board of Investment of Sri Lanka (hereinafter sometimes referred to as BOI). Clause 10 of that agreement is the clause that has given rise to the disputed question in this case. Hence it is reproduced below for convenience.

Clause 10 (I)

".....For a period of seven (07) years reckoned from the year of assessment as may be determined by the Board (hereinafter referred to as "the said tax exemption period) the provisions of the Inland Revenue Act No. 28 of 1979 relating to the imposition payment and recoveries of income tax in respect of the profits and income of the enterprise shall not apply to the profits and income of the Enterprise.

For the above purpose the year of assessment shall mean the year in which the Enterprise commences to make profits in relation to its transactions in that year or any year of assessment not later than Five (05) years reckoned from the date of its commercial production or operation, whichever year is the earlier as determined by and specified in a certificate issued by the Board."

It appears that the Respondent had not made profits although it had begun its operations in the year 1998. The BOI by the documents produced marked **R 2, R 3, R 3A**, has determined that the period of Tax Holiday granted in favour of the Respondent is from 2003-04-01 - 2010-04-01.

In the Assessment in respect of the year 2008/2009 submitted by the Respondent to the Appellant, Rs. 11,715,572.00 has been mentioned as a deduction from the total Statutory Income. The Respondent has deducted this sum from the Statutory Income on the basis that it is the amount the Respondent has incurred as a loss in the previous years which has been carried forward. This is clear from the entries made by the Respondent in "SCHEDULE 5 - LOSSES" in his return produced marked **R 4**. As per the said return following details could be gathered.

Losses brought forward from previous year - 702,232,374.00

Losses incurred in this year - Nil

Total losses - 702,232,374.00

35% of total Statutory Income - 11,715,572.00

Balance loss that can be carried forward to next year - 690,516,802.00....."

It is to be observed that blank spaces for these details to be entered are provided for in the form in which the Respondent is expected to prepare the income tax return.

The Assessor however has refused to accept this assessment on the basis that any loss could be allowed to be deducted from the Statutory Income, if that loss could have been assessable if it had been a profit in terms of the provisions of section 32 (5) (b) of the Inland Revenue Act No. 10 of 2006.

The determination of the Assessor is as follows;

" Refer to the returns of Income, Statements of Audited Accounts and to the agreement your company has entered into with Board of Investment in Sri Lanka. I wish to bring the following facts to your notice.

- 1) This company has entered into an agreement with effect from 30.03.1993 with the Board of Investment. Hence, the provision of the said agreement with the BOI takes effect from that date and the provisions of Inland Revenue Act would not be effective for the payment of Income Tax.

2) A tax loss of Rs. 690.516,802 has shown in 2008/2009 returns as carry forward balance of losses which were originated from the year of assessment 1998/1999.

In terms of Section 32 (5) (b) of the Inland Revenue Act No. 10 of 2006, any loss can be allowed if it had been a profit would have been assessable in terms of the above provisions.

Example: If the year of assessment 1998/1999 had been a profit then the tax exemption period commences from the year of assessment 1998/1999 under the Section 10 of the BOI agreement. In such a situation provisions of the Inland Revenue Act does not operate and on the same reasons loss declared for that year of assessment cannot be treated as an allowable loss.

Where the adjusted losses claimed to be carried forward from year of assessment 1998/1999 onwards cannot be allowed as a deduction under Section 32 of the Act.

Provisions laid down in Inland Revenue Act No. 10 of 2006 should be made applicable for other Income other than income of the enterprise mentioned in the BOI Agreement. Accordingly, if there has been a tax payable in respect of other income of the year, the company becomes liable to pay such tax notwithstanding the declared losses."

It could be seen from the above determination that the Assessor has concluded that the tax exemption period has commenced from the year of assessment of 1998/1999 as per Clause 10 of the BOI agreement. Thus it is clear that what the Assessor had done was to give his own interpretation to Clause 10 of the BOI agreement and had determined the date on which the Tax Holiday begins. This is besides the determination by the BOI that the Tax Holiday is from 2003-04-01 - 2010-04-01.

Thereafter upon an appeal preferred by the Respondent in terms of section 7(3) of the Tax Appeals Commission Act No. 23 of 2011, Senior Commissioner of Inland Revenue has decided that

- a. Since the income tax exemption has been granted for the year of assessment 2007/08 the profit and income of that year of assessment is exempted from Income tax. Hence the losses incurred

during the tax exemption period cannot be considered as a deductible loss as provided under section 32 (5) (b) of the Inland Revenue Act No. 10 of 2006.

- b. Therefore the accumulated losses incurred during the period of 1998/1999 to 2002/2003 claimed as a deduction for the year of assessment 2008/2009 cannot be allowed in terms of section 32 (5) (b) of the Inland Revenue Act No.10 of2006.

The Respondent being dissatisfied with the said determination had thereafter appealed to the Tax Appeals Commission in terms of section 7(2) of the Tax Appeals Commission Act No. 23 of 2011.

The Tax Appeals Commission by its determination dated 2014-02-06 stated as follows.

"... Therefore, it is our View that the tax exemption period granted to the Appellant Company previously commenced from 01.04.2003, as confirmed by the BOI, in its letter dated 03.09.2008, issued in conformity with the said BOI Agreement. Therefore, the provisions of the Inland Revenue Act relating to the imposition, payment and recoveries of income tax in respect of the profit and income of the enterprise shall apply for the period prior to

01.04.2003. Accordingly, the said brought forward losses of the Appellant Company, which has been incurred prior to the said tax exemption period, can be deducted as an allowable deduction, in terms of section 32(5) of the Inland Revenue Act, No. 10 of 2006."

The above positions show that the question to be decided by this Court could be narrowed down to the following single issue. That is "When does the Tax Holiday commence?" Is it the date determined by the Assessor? or is it the date determined by the BOI which has been confirmed by the Tax Appeals Commission?

Section 32(5) (b) of the Inland Revenue Act, No. 10 of 2006 (hereinafter sometimes referred to as the 'Act') is as follows;

Section 32(5)

".... There shall be deducted from the total statutory income of a person for any year of assessment–

(a)

(b) the amount of a loss, other than a loss referred to in paragraph (c) or paragraph (d), incurred by such person in any trade, business, profession or vocation which if it had been a profit would have been assessable under this Act, including any such loss brought forward from a previous year which had not been deducted under this section previously, and any excess treated as a loss under paragraph (ii) of the proviso to paragraph (a), up to a maximum limit of thirty five per centum of the excess of the total statutory income for that year, over the aggregate of :—

(i) Statutory income from interest and dividends referred to in subsection (2);

(ii) any interest income referred to in subsection (3); and

(iii) any reward, share of fine, any lottery winning and any interest on compensation payable, as referred to in subsection (4),

for that year of assessment and any loss which cannot be deducted, may be carried forward to the next year of assessment and so on:

Provided however,

- (A) no loss incurred on the disposal of shares, rights or warrants in a company referred to in section 44 of this Act, shall be a loss deductible under this paragraph;
- (B) no loss shall be carried forward beyond the year of assessment in which the death of such person occurred in the case of an individual, or liquidation of such person occurred in the case of a company or other body of persons;
- (C)
- (D)

"

As per section 32(5)(b) referred to above, if an amount of a loss is to be deducted from the total Statutory Income of a person, such amount of loss could have been capable of being assessed under this Act if it had been a profit. Therefore the question before this court is whether, the loss that has been incurred by the Respondent in the year of assessment 1998/1999 could have been capable of being assessed under this Act, if it had been a profit.

In order to evaluate the arguments advanced by parties before this court, one needs to first assume that this amount of loss was in fact a profit made in the year 1998/1999. The second step would be to ascertain whether such profit made in that year becomes assessable.

Such profit would become non assessable only if that year of assessment namely 1998/1999 becomes a year during the period of the Tax Holiday granted by the BOI. Thus, the next question that arises for consideration is whether that year namely 1998/1999 is within the period of Tax Holiday as per the agreement between the Respondent and the BOI.

According to clause 10(I) of the said agreement marked **R 1** the tax exemption period of 07 years must reckon from the year in which the Respondent commences making profits in relation to its transactions in that year or any year of assessment not later than 5 years reckoned from the date of its commercial production operation, whichever year is the earlier as determined and specified in a certificate issued by the Board.

Admittedly Respondent has not commenced making profits in the year 1998/1999 and thus, cannot be considered as the starting point of the tax exemption period as per the above clause.

Careful consideration of clause 10(I) of the agreement, shows that there must be two basic requirements for tax exemption period to commence. Those two requirements are as follows.

- I. Either the Respondent must have commenced making profits or a period of 5 years must have lapsed from the date of its commercial or production operation.
- II. The BOI must have determined and specified the year (described in "I." above) in a certificate issued by the Board.

Therefore, in any case it is the BOI which must determine the date of commencement of the tax exemption period which must be specified in a certificate issued by the board.

The BOI pursuant to that agreement has determined that the Respondent is entitled to the Tax Holiday period of 5 years commencing from 2003-04-01 to 2003-03-31. The BOI has specified this determination in the certificate dated 2008-09-03.

The said certificate has stated as follows ".....we refer to the principle agreement dated 30th of March, 1993 entered into between the Board of

Investment of Sri Lanka and your enterprise, and confirm that you have complied with the investment criterion as required by clause 10(vii) of the said agreement.

Accordingly your enterprise is entitled for the tax holiday period of five (05) year commencing from 01-04-2003 to 31-03-2008....."

These facts clearly show that the year of assessment 1998/1999 is not qualified to be a year of tax exemption as it has not met any of the two requirements set out above.

Therefore, the year of assessment 1998/1999 is not within the tax exemption period determined by the BOI. Thus, any profit that may have been made during that year becomes assessable under the Act as the tax exemption does not apply to that year.

Therefore any loss that the Respondent had incurred in the year 1998/1999 could be deducted from the total Statutory Income as that amount of the loss could have been assessable under the Act if it had been a profit.

For the foregoing reasons it is the considered view of this court that the Tax Appeals Commission has rightly decided to allow the appeal preferred

by the Respondent. Thus, we answer the question of law formulated for the opinion of this Court in the negative.

In these circumstances we see no merit in this appeal and therefore decide to dismiss this appeal. Determination by the Tax Appeals Commission is hereby confirmed. No cost is ordered.

JUDGE OF THE COURT OF APPEAL

A H M D Nawaz J

I agree,

JUDGE OF THE COURT OF APPEAL