IN THE COURT OF APPEAL OF THE DEMOCRATIC

SOCIALIST REPUBLIC OF SRI LANKA

In the matter of a case stated under section 170 of the Inland Revenue Act, No. 10 of 2006 (as amended)

Indian Overseas Bank,
No. 139, Main Street,
P. O. Box 671,
Colombo 11.

Appellant

Case No. CA/TAX/0010/2016
Tax Appeals Commission
No. TAC/IT/007/2014

Vs.

The Commissioner General of Inland Revenue,
14th Floor, Department of Inland Revenue,
Sir Chittampalam A. Gardiner Mawatha,
Colombo 02.

Respondent

Before **:** Dr. Ruwan Fernando J. &

M. Sampath K.B. Wijeratne J.

: Riad Ameen with Rushantha Rodrigo
for the Appellant

S. Balapatabendi, A.S.G. with Suranga Wimalasena, D.S.G. for the Respondent

Argued on : 28.03.2022 & 03.06.2022

Written Submissions filed on

: 22.06.2018 (by the Appellant)

19.06.2018 (by the Respondent)

Decided on : 15.12. 2022

Dr. Ruwan Fernando, J.

Introduction

[1] This is an appeal by way of a case stated against the determination of the Tax Appeals Commission dated 28.06.2016 confirming the determination made by the Commissioner General of Inland Revenue on 09.07.2014 and dismissing the Appeal of the Appellant. The period relates to the year of assessment 2009/2010.

Factual Background

[2] The Appellant is a banking corporation duly incorporated in India and carrying on banking business in Sri Lanka through a branch office in Colombo. The Appellant is a licensed Commercial Bank in terms of the provisions of the Banking Act, No. 30 of 1998 (as amended). The principal activities of the Appellant include the provision of a comprehensive range of financial services, encompassing banking, corporate, personal, trade, finance, treasury and investment services (Vide-financial statement at p. 55 of the TAC brief).

[3] During the year of assessment 2009/2010, the Appellant received a sum of Rs. 107,415,575/- as interest income on the foreign currency loan granted to the Government of Sri Lanka and filed a Return of Income for the year of assessment 2009/2010. The Appellant claimed the exemption of interest under section 9(b) of the IRA 2006 of a loan granted by the Appellant in foreign currency to the Government of Sri Lanka and the interest of Rs. 91,385,518.97 on borrowing funds from the Central Office, India.

[4] The assessor by letter dated 21.03.2012 refused to grant the exemption of interest claimed by the Appellant under section 9(b) of the IRA 2006 for the following reasons:

1. The Appellant Bank is engaged in the banking business in Sri Lanka and the interest income received by the should be treated as receipts from business and liable to tax unless it is specifically excluded from the IRA 2006;
2. According to the audited statement of accounts, the interest income received by the Appellant on a syndicated loan granted to the Sri Lanka

Government has been treated by the Appellant as income of the Appellant (Colombo branch);

3. The registered office of the Appellant is located in Sri Lanka and therefore, the Appellant is not entitled to the exemption claimed under section 9(b) of the IRA 2006;

4. If any decision is taken to grant the claimed interest income, expenditure incurred in the production of such interest should be identified from the expenses claimed and should be disallowed.

[5] The assessor disallowed the interest income of Rs. 91,385,518.97 at the rate of 10%, which had been paid to the Head Office of the Appellant Bank in India, as specified in the Double Taxation Avoidance Agreement (DTAA) between India and Sri Lanka.

Appeal to the Commissioner-General of Inland Revenue

[6] The Appellant appealed to the Commissioner-General of Inland Revenue (hereinafter referred to as the Respondent) against the said assessment. The Respondent by its determination dated 29.04.2014 confirmed the assessment.

Appeal to the Tax Appeals Commission & the Court of Appeal

[7] Being dissatisfied with the said determination of the Respondent, the Appellant appealed to the Tax Appeals Commission (hereinafter referred to as the TAC) and the TAC held in its determination dated 28.06.2016 that the Appellant is not eligible for the exemption claimed under section 9(b) of the IRA 2006 and dismissed the appeal for the following reasons:

1. The interest received by the Appellant from its core business activity is treated as "turnover" of the Appellant Bank and hence, the interest received by the Appellant during the relevant period falls into the term "turnover" as defined in section 107(3)(c) of the IRA 2006. Therefore, its profits fall exclusively under section 3(a) and not fall under section 3(e). For those reasons, the Appellant should be treated as carrying on the business of banking and therefore, the investment in government development bonds and the foreign currency loan granted to the government of Sri Lanka to earn income interest has to be treated as part of the banking activity, which is liable to tax, unless excluded by any other provision of the IRA 2006;

2. In *Ceylon Financial Investment Ltd v. Commissioner of Income Tax*, 43 NLR 01, the Supreme Court unanimously held that the income of a company derived from dividends and interest falls within the words "profits and income" under section 6(1)(a) of the Income Tax Ordinance, 1932, which is similar to section 3(a) of the IRA 2006;
3. Section 9(b) of the IRA 2006 applies to any person or partnership outside Sri Lanka. The Appellant (Indian Overseas Bank, Colombo Branch) is operating under a licence granted in terms of section 5 of the Banking Act, No. 30 of 1988, to function as a domestic banking unit in Sri Lanka. The Appellant (Indian Overseas Bank, Colombo Branch) is therefore, not a "person outside Sri Lanka" to qualify for the interest exemption claimed under section 9 (b) of the IRA 2006.

Appeal to the Court of Appeal & Questions of Law

[8] Being dissatisfied with the said determination of the TAC, the Appellant appealed to the Court of Appeal and formulated the following questions of law in the Case Stated for the opinion of the Court of Appeal.

1. Did the Commission err in law in holding that the interest earned by the Appellant on the loan granted to the Government of Sri Lanka, in respect of which the Appellant claimed exemption in terms of section 9 (b) of the Inland Revenue Act, No. 10 of 2006, exclusively fell within Section 3 (a) of the said Act?
2. Did the Commission err in law in misreading the decision of Honourable Justice Soertsz in the case of *Ceylon Financial Investment Ltd v. Commissioner of Income Tax* (Reports of Ceylon Tax Cases, Volume 1, page 234) when the Commission said that honourable Justice Soertsz and De Krester held that dividends and interest received by a company fell only within the words "profits of a business" of Section 6 (1) (a) of the Income Tax Ordinance and not within Section 6 (1) (e) of the Income Tax Ordinance, whereas honourable Justice Soertsz did not hold such a view at all, although such a view has been erroneously attributed to Justice Soertsz by the editor of the case in the head note to the case? (Honourable Justice De Krester did not write an opinion; he merely agreed with the views of honourable Justice Soertsz);

3. Did the Commission err in law, in holding, on the basis of the errors referred to in the preceding questions of law, that the Appellant is not entitled to the exemption claimed in terms of Section 9 (b) of the Inland Revenue Act?

4. Did the Commission err in law in its failure to act on the basis of the unanimous decision of the judges of the supreme court in the case of *Ceylon Financial Investments Ltd Vs. Commissioner of Income Tax* according to which-

    a. Interest and dividends derived by a company fell within both paragraphs (a) and (e) of Section 6 of the Income Tax Ordinance which paragraphs are similar to paragraphs (a) and (e) respectively of Section 3 of the Inland Revenue Act, No. 10 of 2006; and

    b. Any special provisions applicable to dividends and interest apply to dividends and interest treated as falling within paragraph (a) of Section 6 of the Income Tax Ordinance?

5. Did the Commission err in law in its failure to recognize, and, to act on that basis, that, for all purposes of law, it is the Indian Overseas Bank of No. 763, Anna Salai, Chennai 600 002, India, (and not the branch which is not a person) which, according to the commission itself is a non-resident banking institution, is the granter of the loan in question and the person contemplated in Section 9 (b) of the Act?

6. Is not the Indian Overseas bank referred to in the preceding question of law entitled to the exemption it claimed in terms of Section 9 (b) of the Inland Revenue Act in respect of the interest it received on the foreign currency loan it gave to the government of Sri Lanka through its branch in Colombo?

7. Did the commission fail to properly examine and/or apply and/or appreciate the facts and the law relevant to this matter?

[9] At the hearing of the appeal, we heard Mr. Riad Ameen, the learned Counsel for the Appellant, and Mr. S. Balapatabendi, A.S.G. for the Respondent on the seven questions of law submitted for the opinion of the Court.

Matters to be determined

[10] The questions of law submitted for the opinion of this Court relate to the following main issue:

> Whether on the facts and circumstances of the case, the interest income of Rs. 107,415,575/- in foreign currency derived from the loan granted to the Government of Sri Lanka should be exempted under section 9(b) of the Inland Revenue Act, No. of 2006.

Analysis

Is interest received by the Appellant a source of income under section 3(a) or section 3(e) of the Inland Revenue Act?

[11] Now the question is to consider whether the interest income can be categorized as "profits and income" earned by the Appellant from business falling within the ambit of section 3 (a) of the IRA 2006, and if not, whether the interest income can also fall within the ambit of section 3(e) of the IRA 2006.

[12] Mr. Ameen submitted that the interest received by the Appellant should be treated as a source under section 3(e) of the IRA 2006, which specifically refers to interest whereas section 3(a) does not specifically refer to interest. He submitted that although there is no specific reference to interest in section 3(a), it is possible for interest to be a source under section 3(a), if it can constitute a profit from business as observed by the judges in *Ceylon Financial Investments Limited V. Commissioner of Income Tax* (supra) (hereinafter referred to as the 'CFI judgment'). He submitted however, that the judges in the CFI case concluded that the interest income is a source under section 6(1)(a) of the Income Tax Ordinance 1932 (correspond to section 3(a) of the IRA 2006), instead of section 6(1)(e) (corresponding to section 3(e) of the IRA 2006).

[13] Mr. Ameen strongly relied on the five-bench decision of the Supreme Court in *Ceylon Financial Investments Limited V. Commissioner of Income Tax* (supra) in support of his contention that the interest received by the Appellant is a source under section 3(e), which can be clearly separated from the rest of its business, and therefore, the special provisions relating to interest under section 9 (b) and 9(d) of the IRA 2006 should apply to interest received by the Appellant. He submitted that contrary to the decision in *Ceylon Financial Investments Limited V. Commissioner of Income Tax* (supra), the TAC erroneously decided that the Appellant's interest income falls within the meaning of section 3(a), instead of

section 3(e) of the IRA 2006 and therefore, section 9 of the IRA 2006 has no application in terms of the provisions of section 99 of the IRA 2006.

[14] It is not in dispute that section 6(1)(a) of the Income Tax Ordinance 1932 is corresponding to section 3(a) of the IRA 2006 and section 6(1)(e) of the Income Tax Ordinance 1932 is corresponding to section 3(e) of the IRA 2006. Mr. Balapatabendi, however, disputed the submission of Mr. Ameen that the source of profit or income could fall within two separate subsections in section 3, and that the judgment in CFI is no authority for the assertion of the Appellant that the source of profits or income could fall within two separate subsections of section 3. He further submitted that section 47 of the Income Tax Ordinance (current section 99 of the IRA 2006), that was in force at the time of the judgment, would have statutorily precluded the Supreme Court from making a pronouncement that a source of profit/income could fall within two separate subsections of section 6 (1) of the Income Tax Ordinance 1932

[15] At the hearing, we had the benefit of full and able arguments from Mr. Ameen and Mr. Balapatabendi, who made extensive submissions with regard to the applicability of the judgment in CFI case to the determination of the profits or income of the Appellant, either under section 3(a) or 3(e) of the IRA 2006. The Respondent also relied on the judgment of CFI in deciding whether the profits or income of the Appellant falls under section 3(a) or 3(e) of the IRA (pp.25-26, 167 of the TAC brief) It is therefore, necessary to identify the ratio of the said judgment and decide whether the interest can be a source under section 3(a) or 3(e) of the IRA 2006, and if so, in what circumstances will interest can be a source under section 3(a) or 3(e) of the IRA 2006.

Characterization of profits and income earned by the Appellant under section 3 (a) or 3 (e) of the IRA 2006.

[16] For the purpose of the determination of the Questions of Law, it is necessary, first, to decide whether the interest income received by the Appellant is a source of income under section 3(a) or 3(e) of the IRA 2006. Before I embark upon the rival contentions of the parties, I may proceed to consider the relevant statutory provisions which have a bearing on the issue before this Court. Section 2 of the IRA 2006 provides that "*income tax shall, subject to the provisions of this Act, be charged at the appropriate rates specified in the First, Second, Third, Fourth and Fifth Schedules to this Act, …in respect of the profits and income of every person for the year of assessment*….".

[17] Section 3 of the IRA 2006 specifies different sources of income and profits which are chargeable with income tax. Section 3(a) of the IRA 2006 provides as follows:

"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".

[18] On the other hand, section 3 (e) of the IRA 2006 refers to income received from dividends, interest or discounts. It provides:

(e) "dividends, interest or discounts".

[19] It may be noted that the classification of the source of income is significant as different rates apply to different sources of income specified in the five Schedules to the IRA 2006. In the circumstance, it is necessary for the assessor to ascertain and 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. The list of heads in section 3 is the list of sources is one source such as "profits from one business" in section 3(a) is distinct from "employment" in section 3(b), or business in section 3(a) is distinct from "dividends, interest or discounts" as a source. One of the heads (sources) is the "profits from any trade, business, profession or vocation for however short a period carried on or exercised" under section 3(a), and the other is "dividends, interest or discounts" under section 3(e) of the IRA 2006.

Judgment of the Supreme Court in *Ceylon Financial Investments Limited V. Commissioner of Income Tax* (CFI Case)

[20] I will now turn to the CFI judgment. The facts of the CFI judgment reveal that the assessee company was an **investment company** and its object was to invest money in shares in other companies. Its income was derived from dividends declared by companies in which it owned shares, and interest on moneys lent out by it. The company did not carry on any trade and claimed deductions from outgoings and expenses in the production of the profits or income within the meaning of section 9(1) of the Income Tax Ordinance (Chapter 188) (corresponding to section 25(1) of the IRA 2006).

[21] Unlike in the present case, the assessee argued in the CFI case that the interest income should be treated as a source under section 6(1)(a) of the Income Tax Ordinance 1932 (corresponding to section 3(a) of the IRA 2006), and the assessor in disallowing the management expenses claimed drew a distinction between an investment company and a company which carried on a trade or commercial enterprise. The assessor stated however, that (i) an investment company does not incur any expense in the production of income, and once the investment was made, no further expenditure was necessary for the production of its income from the investment; and (ii) section 10(b) also precluded any such deduction as claimed. The assessor treated the interest income under section 6(1)(e) of the Income Tax Ordinance 1932 (corresponding to section 3(e) of the IRA 2006) and disallowed the deduction of management expenses in producing its interest income in terms of section 9(3) of the Income Tax Ordinance 1932 (corresponding to section 25 (4) of the IRA 2006). The Commissioner also disallowed the management expenses claimed as deductions from the income of the company and the Board of Review confirmed the determination of the Commissioner.

[22] It is relevant to note that there was no dispute in the CFI case that the appellant company though functioning as an investment company only, and that the investment was the purpose for which it was formed, it still continued to carry on business in the way of a holding company. The issue in CFI case was whether the management expenses (such as Directors', Secretaries' and Auditors' fees) could be deducted from its income derived from dividends and interest in ascertaining the assessable income of the company under section 9(1) of the Income Tax Ordinance 1932 (corresponding to section 25(1) of the IRA 2006). The CFI judgment dealt with the following two issues:

1. whether the income derived from dividends and interest was a source under section 6(1)(a) or section 6(1)(e) of the Income Tax Ordinance, 1932;
2. Even if the appellant company was carrying on a business and for that reason, came under section 6(1)(a), was entitled to deduct the management expenses derived from dividends and interest in ascertaining the net profits and income, whether under section 9(1) or 9(3) of the Income Tax Ordinance;
3. Even if the appellant company was carrying on a business and for that reason, came under section 6(1)(a), and the gain derived from dividends

and interest falls within the words "dividends, interest or discounts" of section 6(1)(e), whether the Income Tax officer was entitled to elect under which heads 6(1)(a) or 6(1)(e), it will make its assessment.

Whether, in terms of the CFI judgment, the income derived from dividends, interest or discounts falls within the words "profits from any business" under section 6(1)(a) or within the terms "dividends, interest or discounts" under section 6(1)(e) of the Income Tax Ordinance, 1932,

[23] The first question that was considered by the judges in the CFI case was whether the income derived by the company from dividends and interest was a source under section 6(1)(a) or section 6(1)(e) of the Income Tax Ordinance, 1932, which corresponds to section 3(a) and 3(e) of the IRA, No. 10 of 2006 respectively.

[24] The argument of the Appellant, in that case, was that income should have been assessed under section 6(1)(a) of the Ordinance as a business and therefore, such expenses should have been allowed under section 9(1) (current section 25(1) of the IRA 2006) as *"all outgoings and expenses incurred by such person in the production thereof"*. The Crown argued that the profits or income of the assessee came exclusively under section 6(1)(e) (current section 3(e) of the IRA) and could not be regarded as the profits and income of a business. Alternatively, the Crown argued that if the profits and income came under both section 6(1)(a) and under section 6(1)(e), the Crown had an option as to the sub-section under which the tax could be charged.

[25] It may be noted that section 9(1) of the Income Tax Ordinance, which relates to the deductions allowed in ascertaining profits or income, is identical to section 25(1) of the IRA. It reads as follows:

> *"(1) Subject to the provisions of subsections (2), and (3), there shall be deducted, for the purpose of ascertaining the profits of income of any person from any source, all outgoings and expenses incurred by such person in the production thereof…."-*

[26] Section 9(3) of the Income Tax Ordinance is identical to section 25(4) of the IRA 2006 and it reads as follows:

> *"(3) Subject as hereinafter provided, Income arising from interest shall be the full amount of interest falling due, whether paid or not, without any deduction for outgoings or expenses:"*

[27] Section 10) (b) of the Income Tax Ordinance reads as follows:

"For the purpose of ascertaining the profits or income of any person from any source, no deduction shall be allowed in respect of ……,

(b) any disbursements or expenses not being money expended for the purpose of producing the income".

[28] In the light of those facts and the arguments advanced on behalf of the assessee and the assessor, the Supreme Court proceeded to consider first, whether the source of profits and income of the assessee in that case fell within the meaning of section 6(1)(a) or section 6(1)(e) of the Income Tax Ordinance. The judges in the CFI case then proceeded to lay down tests for determining whether interest was a source of income under section 6(1)(a) or 6 (1)(e) of the Income Tax Ordinance. Howard C.J., Keuneman J. and Soertsz J. delivered separate judgments, and De Kretser, J. did not deliver a separate judgment, but agreed with the judgment of Soertsz, J. Wijewardene, J. delivered a brief judgment, but agreed with the reasoning of Keuneman J.

[29] It is relevant to note that in the CFI judgment, both Howard C.J., and Keuneman J. recognized that the income derived from dividends and interest falls within the words "profits from business" under section 6(1)(a), or within the terms "dividends, interest or discounts" under section 6(1)(e) of the Income Tax Ordinance (pp. 7, 8, & 19). Howard, C.J. then proceeded to consider in what circumstances will interest be a source under section 6(1)(a) or under section 6(1)(e). In order to determine this question, Howard C.J. laid down the following test at page 250 of the judgment:

"*If the business of a company consists in the receipt of dividends, interest or discounts alone or if such a business can be clearly separated from the rest of the trade or business, then any special provisions applicable to dividends, interest or discounts must be applied. Applying the principle laid down in the Egyptian case, the appellant company is within source (e) and cannot get out of it. To take such a view does not in any way disturb the scheme of the Ordinance. I agree, therefore, with Keuneman J. that the Commissioner was empowered to charge the appellant Company under section 6 (1) (e) in respect of the dividends and interest received from undertakings in which its capital was invested"* (Emphasis added).

[30] Howard C.J. held that the company is within source (e) and cannot get out of it and therefore, the Commissioner was empowered to charge the company under section 6(1)(e) in respect of dividends and interest received from undertakings in which its capital was invested (p 11). Howard C.J. then proceeded to consider whether the management expenses are deductible under section

9(1) as outgoings and expenses incurred "*in the production of the profits*". Howard C. J. held that as section 9(1) employs the word "any source", it must be regarded as having reference to section 6(1). Accordingly, Howard C.J. opined that "the management expenses of the appellant company are deductible as incurred in the production of the profits" (p. 7.

[31] Keuneman, J., while disagreeing with Howard, C.J. on the option available to the Income Tax Commissioner, however, agreed with the test adopted by Howard C.J. Keuneman J. first proceeded to consider in what circumstances will interest be a source under section 6(1)(a) or under section 6(1)(e). Keuneman J., laid down the following test at pp. 261-262 of the judgment:

> *'How then are we to treat income which comes under source (e) but can also be regarded as coming under source (a)? In my opinion, it was the intention of the Ordinance to regard dividends, interest or discounts as a separate source. If then the business of an individual or a company consists in the receipt of dividends, interest or discounts alone, or if the business of receiving dividends, interest or discounts can be clearly separated from the rest of the trade or business, then any special provisions applicable to dividends, interest or discounts must be applied. I do not think any question of opinion arises.* (Emphasis Added).

Option of the Income Tax Officer to elect the source of income under section 6(1)(a) or 6(1)(e)

[32] In the question whether the Crown had an option to elect the source of income, the majority of the Judges, comprising Keuneman J., Soertsz J. and Kretser J. held that the Crown had no option to elect whether it will assess under section 6(1)(a) or 6(1)(e). Keuneman, J. specifically stated at p. 20 that section 47 of the Income Tax Ordinance, which correspond to section 99 of the IRA 2006 lends support to this view.

Deduction of Management Expenses

[33] The next question in the CFI case was whether management expenses were incurred in the production of profits and deductible under section 9(1) of the Income Tax Ordinance. The deductions claimed by the Appellant in the CFI case were "outgoings and expenses incurred in the production" of the profits or income within the meaning of section 9(1) of the Income Tax Ordinance. The Crown argued that the management expenses were not incurred in the production of profits and income. It was not in dispute that though the

appellant company in the CFI case was formed as an investment company, it carried on business in the way of a holding company and that everything that accrued to the company, in the course of its business, by way of pecuniary gain, whether by way of dividends, interest, discounts or some other thing falls within the words "profits from any business".

Expenses incurred in the production of dividends

[34] Both Howard C. J, and Keuneman J. turned to the management expenses incurred in relation to dividends, arising from the production of income and held that they are necessary and reasonable expenses (p. 22). Howard C.J. and Keuneman J. recognized that section 9(1) which relates to ascertaining of profits and income of any person applies to "all the sources" of income set out in section 6(1), but places interest on a different footing under section 6(1)(e), if such interest can be separated from the rest of the trade or business.

[35] Howard C.J. having regard to the facts of the case, held that the income derived by the Appellant from dividends and interest falls within the meaning of section 6(1)(e) of the Income Tax Ordinance, and the management expenses can be deducted as outgoings and expenses incurred in the production of income and profits under section 9(1). Howard C.J. agreed with Keuneman J. that the Commissioner was empowered to charge the company under section 6(1)(e) in respect of dividends and interest received in the production of profits and income under section 9(1) of the Income Tax Ordinance.

Expenses incurred in earning dividends

[36] As far the deduction of management expenses in relation to dividends, which the company obtained was concerned, Keuneman J. rejected the submission of the Crown that the company has not done anything to produce the income or profits under section 9(1). Keuneman J., held that section 9(1) "would therefore *prima facie* apply to all the sources in section 6(1)(a) to (h)" (p. 21). Keuneman J., further rejected the argument of the Crown that nothing has been done by the company to produce the income or profits, and held that the management expenses claimed in the case have been incurred in the production of the income. Keuneman J., further held that management expenses incurring in the production of income can be deducted from any source, including from source 6(1)(e) and agreed with Keuneman J. that management expenses incurred by the company could be deducted under section 9(1) of the Income Tax ordinance.

[37] Keuneman J. decided that the management expenses can be deducted as far as they relate to the dividends which the company obtained in producing the profits or income under section 9(1) of the Income Tax Ordinance 1932.

Expenses incurred in the production of interest-special considerations

[38] In relation to the interest, it was the opinion of Keuneman J. that though the interest is a separate source under section 6(1)(e), that source is subject to all outgoings and expenses incurred in the production of the profits or income, and thus, they must be deducted. Keuneman J. then turned to the deduction of interest income earned by the company and referred to section 9(1) and 9(3) of the Income Tax Ordinance. Section 9(1) refers to the deductions for the purpose of ascertaining the profits or income from any source, all outgoings and expenses incurred by any person in the production thereof and section 9(3) refers to income arising from separate interest, whether paid or not, without any deduction for outgoings or expenses.

[39] Keuneman J. held that had the earning of interest been the sole and separate business of the company, the special provision in section 9(3) (corresponding to section 25(4) of the IRA 2006) would apply. Keuneman J. however, refused to apply the special provision in section 9(3) on the basis that the company carried on one business, which has two branches, viz. the earning of dividends and earning of interest, but the interest is only a subsidiary part of the business, which is not separated from its ordinary financial business. Accordingly, Keuneman J., refused to apply the special provision in section 9(3), which corresponds to section 25(4) of the IRA 2006. But His Lordship applied the general rule of deduction under section 9(1), which corresponds to section 25(1) of the IRA 2006. The findings of Keuneman J. at p. 22 of the judgment read as follows:

> *"What is the position as regards the items of interest earned by the company? Had the earning of interest been the sole or separate business of the company, no doubt the special considerations under section 9(3) would have been applicable. But it is clear in this case that the company carries on one business, which has two branches, viz., the earning of dividends and the earning of interest and it is clear on the figures available to us (see Document X) that interest is only a subsidiary part of the business, and is not separated from its ordinary financial business. The interest is "embedded" in the business (in the words of Rowlatt J.) or "a mere incident" in the business (in the words of Lord Hanworth M.R.)-see Butler v. The Mortgage Company of Egypt, Ltd. I do not think it can be separated off or identified as distinct from*

the general business of the company. I do not ***think therefore that these items are assessable as such. The ordinary rule under section 9(1) therefore applies and the deductions claimed can be allowed in their entirety*** *[emphasis added].*

[40] On the question whether or not the deductions mentioned in the general rule under section 9(1) (corresponding to section 25(1) of the IRA) applies to all "sources" of income under section 6(1), Keuneman J. held that the deductions mentioned in section 9(1) apply to all "sources of profit and income" in the following words (p. 23):

> *"I only repeat that the deductions mentioned in section 9 apply to all "sources" of profit and income".*

[41] It is relevant to note that Keuneman J. took the view that section 9(3) applies where the interest is a separate source which is not embedded in the business in producing its aggregate income and refused to apply section 9(3) as the income was embedded in its general activities in producing its aggregate income.

[42] Having considered the word "any source" which is employed in section 9(1), which refers to either 6(1)(a) or 6(1)(e), Keuneman J. deducted the management expenses in relation to interest earned by the company under the general rule in section 9(1) (correspond to section 25(1) of the IRA) and not under the special rule in section 9(3). On that basis, the deduction of management expenses claimed arising from interest was allowed as outgoings and expenses incurred in the production of the income under section 9(1), which corresponds to section 25(1) of the IRA 2006.

[43] Applying the said principles of law, Keuneman J. finally allowed the appeal and deducted the management expenses incurred in the production of income in relation to dividends and interest in ascertaining the assessable income of the company under section 9(1) (corresponding to section 25(1) of the IRA).

[44] The combined effect of the test applied by Howard CJ., and Keuneman J. (with Wijewardene, J. agreed) was that "if the business of a company or individual consists in the receipts of dividends, interests or discounts alone, or if such business can be clearly separated from the rest of the trade, business, then section 3(1)(e) will apply. In other words, if the business of a company or an individual consists in the receipts of dividends, interest or discounts and such business cannot be separated from the rest of the trade or business, and the

interest is embedded in the business, such interest or dividends or discounts falls within the meaning of section 3(1(a) of the Act.

[45] The test adopted by Howard CJ., and Keuneman J. applies to identify in what circumstances will dividends, interest or discounts be a source under section 6(1)(a) or under section 6(1)(e). That test has no application to the deductions of expenses mentioned in section 9(1) or 9(3), which relate statutory exemptions. Accordingly, the CFI judgment ultimately determined the deduction of expenses derived from dividends and income separately by the application of the general rule under section 9(1) and the special deduction rule under section 9(3). Both Howard CJ., and Keuneman J. confirmed that though the source of income falls under section 6(1)(e), which stands on a different footing in section 6(1), section 9(1) applies to all sources, whether under 6(1)(a) or 6(1)(e) and thus, to all outgoings and expenses incurred in the production thereof. Accordingly, the management expenses incurred in the production of income or profits earned from dividends and interest were held to be deductible under the general rule in section 9(1).

[46] It is relevant to note however, that Soertsz J. (with whom de Kretser J., agreed) disagreed with Keuneman J. that it was the intention of the Ordinance to regard dividends, interest or discounts as a separate source (p. 252). Soertsz J. held that the question whether it was profits from dividends or interests or discounts falls within section 6(1) or 6(1)(e), and depends on whether or not the **assessor deals with the profits of a "business"** or the **income of an "individual**". Soertsz J. held that where it is appertaining to an income of a business, it falls within 3(1)(a), and where it is related to an income of an individual, as part of his business, it falls within section 6(1)(e). The relevant passage of the judgment at p. 252 reads as follows:

> "*The view I have reached is that the categories enumerated in section 6 (1) are mutually exclusive, and that the question whether 6 (1) (a) or 6 (1) (e) applies in a particular case, depends on whether we are dealing with the profits of a business or the income of an individual. If it is a case of dividends, interests, or discounts appertaining to a business, they fall within the words "profits of any business" and section (6) (1)(a) applies. If, however, it is a case of dividends, interest or discounts accruing to an individual not, in the course of a business, but as a part of his income from simple investments, then section 6 (1) (e) is the relevant section, and so far as interest is concerned, section 9 (3) modifies section 9 (1)*" (Emphasis added).

[47] The above passage of the judgment of Soertsz J. suggests that the following test would apply to identify whether the profits and income of an individual or business fall within section 3(1)(a) or 3(1) (e):

1. If the profits or income received from dividends or interest or discounts appertains to the business, it will fall within the profits of any business under section 6(1)(a);
2. If the profits or income received from dividends or interest or discounts accruing to an individual was earned, not in the course of a business, but as a part of his income from simple investments, it falls within section 3(1)(e).

[48] The test applied by Soertsz J. that section 6(1)(e) is limited to an income of an "individual" and section 6(1)(a) is limited to the profits of any "business" is not, in my view consistent with the scheme of the IRA 2006, which does not restrict the application of section 3(1)(e) to an individual. In my view, the tests laid down by Howard CJ., and Keuneman J., are significant to identify the source of profits or income under which chargeability arises and to decide in what circumstances, will the dividends, interest or discounts be a source under section 3(a) or 3(e). The identification of the source of profits or income is also significant to apply the general rule of deduction under section 25(1) or special rules of deduction under section 25(1)(a) -(w) of the IRA 2006 to particular sources or profits or income, irrespective of whether the source falls under section 3(a) or 3(e) of the IRA 2006.

[49] Applying the above principles adopted in the majority decision of the CFI judgment, we will now proceed to consider whether the interest income earned by the Appellant falls within the words "profits from any business" under section 3(a) or under the term "interest" under section 3(e) of the IRA 2006.

Double Taxation Avoidance Agreement (DTAA) between India and Sri Lanka

[50] Before, we proceed to classify the source of income of the Appellant under section 3(a) or 3(e), it is relevant to consider the effect of the Double Taxation Avoidance Agreement (hereinafter referred to as the "DTAA") between India and Sri Lanka. The DTAA applies to taxes on income and capital imposed on behalf of each Contracting State irrespective of the manner in which they are levied (Article 2.2). The existing taxes to which this Convention shall apply in Sri Lanka are (i) the income-tax, including the income-tax based on the turnover of

enterprises licensed by the Greater Colombo Economic Commission; and (ii) the wealth-tax (Article 2.3).

[51] The DTAA is a contract between two Sovereign Governments of India and Sri Lanka, and the contract has been signed by the two sovereign governments with full knowledge, understanding and free consent of both governments. Relief by way of an exemption shall be considered in case of a DTAA in terms of Section 97 of the Inland Revenue Act, No. 10 of 2006. Section 97 reads as follows:

> *"97 (1) (a) Where Parliament by resolution approves any agreement entered into between the Government of Sri Lanka and the Government of any other territory or any agreement by the Government of Sri Lanka with the Governments of any other territories, for the purpose of affording relief from double taxation in relation to income tax under Sri Lanka law and any taxes of a similar character imposed by the laws of that territory, the agreement shall, notwithstanding anything in any other written law, have the force of law in Sri Lanka, in so far as it provides for–*
>
> *(i) relief from income tax;*
> *(ii) determining the profits or income to be attributed in Sri Lanka to persons not resident in Sri Lanka, or determining the profits or income to be attributed to such persons and their agencies, branches or establishments in Sri Lanka;*
> *(iii) determining the profits or income to be attributed to persons resident in Sri Lanka who have special relationships with persons not so resident*
> *(iv) exchange of information; or*
> *(v) assistance in the recovery of tax payable.*

[52] There are two situations under which the relief can be achieved in Sri Lanka under the DTAA between India and Sri Lanka:

(a) Where income tax has been paid under the IRA 2006 of Sri Lanka and the corresponding Indian Income Act or income tax remains taxable in both countries (whether at a full or reduced rate), as the country of residence, Sri Lanka will give a tax credit for the purpose of Sri Lankan taxation; or

(b) Where exemption from taxation exists, Sri Lanka may grant the **exemption from income tax in respect of the agreed source of income** under the DTAA subject to conditions laid down in the domestic law or the DTAA.

[53] As per the IRA 2006 (s. 97), where the government has entered into a DTAA, then in relation to the assessee to whom such Agreement applies, the provisions

of the DTAA, with respect to cases to which they would apply, would operate even if inconsistent with the provisions of the IRA 2006. As a consequence, if a tax liability is imposed by the provisions of the IRA, the DTAA may be referred to and relief may be granted either by deducting or reducing the tax liability, and the Treaty provisions would prevail, and are liable to be enforced in Sri Lanka and India.

[54] It is not in dispute that the Appellant is a non-resident banking institution operating through a branch in Sri Lanka and thus, it has a permanent establishment (PE) in Sri Lanka within the meaning of Article 25 of the Double Taxation Avoidance Agreement between India and Sri Lanka. The Appellant who is carrying on business in Sri Lanka through a permanent establishment (PE) is therefore, subject to the Sri Lankan tax laws in respect of profits attributable to its permanent establishment (PE) in Sri Lanka subject to the stipulations of relevant laws in Sri Lanka.

Business activities of the Appellant & the profits and income claimed by the Appellant

[55] It is relevant to note that the issue in the CFI judgment related to the deduction of management expenses incurred in the production of dividends and interest under section 9(1) of the Income Tax Ordinance 1932. In the present, the issues relate to the exemption of income derived from loans, investment of moneys in the government securities and euro deposits in banks under section 9(b) and 9(d). The issue also relates to the interest expenses incurred in relation to Government Development Bonds under section 9(f) of the IRA 2006.

[56] In determining whether the interest income falls under section 3(a) or 3(e) of the IRA 2006, it is necessary to identify the business activities of the Appellant and the profits and income claimed by the Appellant under a particular source of income. As noted, section 3 enumerates the sources and categories of profits and income that are subject to tax and therefore, it includes any "profits and income" or "profits" or "income" from any source listed in paragraphs (a)-(j) of section 3 of the IRA 2006. The definition in section 217 provides that "profits" or "income" means the net profits or income from "any source" for any period calculated in accordance with the provisions of the Act. The term "income" is not however, defined.

[57] In *Thornhill v. The Commissioner of Income Tax* (supra), the main question was whether the sum of Rs. 19,622.19 was received by the Appellant in respect of his estate under the Tea and Rubber Control Ordinance as tea and rubber coupons to which he was entitled under the said Ordinance, and realised by the sale of these coupons constituted profit or income within the meaning of Section 6 (1) (a) or 6 (1) (b), or whether it represented realisation of capital.

[58] Soertsz J. in that case referred to the statement made in *Tennant v. Smith* (1892) A.C. 150 that "for income tax purposes, 'income' "must be money or something capable of being turned into money". But, Soertsz J. held however, that this statement needs qualification as all moneys and all things capable of being turned into money are not necessarily "income" for tax purposes. Soertsz J. referred to the following essential characteristics of "income" identified by Cunningham and Dowland in their Treatise on "Land and Income Tax and Practice", at p. 128, and held that these essential elements provide adequate tests by which to ascertain whether a particular receipt is "income" or not within the meaning of the Income Tax Ordinance. They are:

(a) It must be a gain;

(b) It must actually come in, severed from capital, in cash or its equipment;

(c) It must be either the produce of property or/and the reward of labour or effort;

(d) It must not be a mere change in the form of, or accretion to, the value of articles in which it is not the business of the taxpayer to deal; and

(e) It must not be a sum returned as a reduction of a private expense.

[59] Having applied the above-mentioned tests, Soertsz J. held *inter alia,* that (i) the amount in question is "profits and income" derived from the business of an agricultural undertaking carried on by the appellant, and is therefore assessable under section 6 (1) (a); (ii) if it does not fall within the scope of section 6 (1) (a), it is caught up by the "residuary" subsection 6 (1) (h) as this is not something casual or something in the nature of a windfall.

Meaning of "carried on or exercised" in section 3(a)

[60] Now, it is necessary to determine whether or not the Appellant carried on a business and earned profits from such business within the meaning of section 3(a), or merely received an income on a different footing, which can be separated from its business income within the meaning of section 3(e) of the IRA 2006. It

is relevant to note that "the profits from any trade, business, profession or vacation for however short period." in section 3(a) is subject to a qualifying phrase "**carried on or exercised".** The word "business" has been defined in Section 217 of the Inland Revenue Act of 2006. It reads as follows:

> *"Business" **includes** an agricultural undertaking, the racing of horses, the letting or leasing of any premises, **including** any land by **a company and the forestry**".*

[61] The definition of "business" in Section 217 is inclusive and not exhaustive in nature and thus, it includes an agricultural undertaking, the racing of horses, the letting or leasing of any premises, including any land by a company and the forestry. Jessel M.R. in *Smith v. Anderson* [1880] 15 Ch D 247 (CA) stated that (i) the word " business " is a word of large and indefinite import and it is something which occupies attention and labour of a person for the purpose of profit; and (iii) the word means almost anything which is an occupation or duty requiring attention as distinguished from sports or pleasure; (iii) it is used in the sense of occupation continuously carried on for the purpose of profit. He explained the word "business" at pp. 258-259 as follows:

> *"Now "business" itself is a word of large and indefinite import. I have before me the last edition of* Johnson's Dictionary, *edited by Dr.* Latham, *and there the first meaning given of it is, "Employment, transaction of affairs"; the second, "an affair"; the third, "subject of business, affair, or object which engages the care." Then there are some other meanings, and the sixth is, "something to be transacted." The seventh is, "something required to be done." Then taking the last edition of the* Imperial Dictionary, *which is a very good dictionary, we find it a little more definite, but with a remark which is worth reading: "Business, employment; that which occupies the time and attention and labour of men for the purpose of profit or improvement." That is to say, anything which occupies the time and attention and labour of a man for the purpose of profit is business. It is a word of extensive use and indefinite signification. Then, "Business is a particular occupation, as agriculture, trade, mechanics, art, or profession, and when used in connection with particular employments it admits of the plural that is, businesses."*

[62] The words "carrying on or exercised" are not defined in the Act. Section 3(a) however, includes every trade, business, [profession or vacation however short a period. The question whether a person is or is not carrying on business is an inference from facts and the circumstances each case. As a general rule, one of two isolated transactions could not be described as the carrying on of a business subject however, to certain exceptions (Sikke on South African Income Tax, 3rd

Ed. 1965, p. 478). For example, a single transaction is of such a nature that it could be correctly described as a business (supra).

[63] In considering whether a taxpayer is carrying on business, **the frequency, systematically and regularity of the action or the earning of the income involves the conduct of a series of action that give rise to the carrying on a business** (Sikke on South African Income Tax, 3rd Ed. 1965, p. 478). On the other hand, the investment of surplus funds in shares in companies, as long as it forms part of a general scheme of profit-making, can be regarded as carrying on business (supra).

[64] It is settled law that the terms "carrying on or carrying out "appears to cover the habitual pursuit of a course of conduct for the purpose of earning profits with proof of continuity. The following statement made by Brett, L.J. in *Erichsen v. Last* (1881) 4 TC 422, at p. 425 is significant to ascertain whether a business is exercised or carried on or transacted in a country:

> *"Now, I should say that whatever profitable contracts are habitually made in England, by or for a foreigner with persons in England because these persons are in England, to do something to those persons and, such foreigners are exercising are exercising a profitable trade in England, even although everything done by or supplied by them in order to fulfil their part of the contract is done abroad".*

[65] The Appellant has been assessed by the assessor on the basis that the interest income earned by the Appellant from its banking business is a source that falls within the terms "trade, business …for however short a period **carried on or exercised"** in section 3(a) of the IRA 2006. The Appellant concedes that the interest received by a bank can fall to be treated as "profits of a business" falling within section 3(a) of the IRA 2006 as well as section 3(e) of the IRA 2006 (p. 74 of the TAC brief). The Appellant's stand is however, that the special provisions relating to interest under section 9 applies even if the interest comes within section 3(a) of the IRA on the basis of the judgment in CFI case (vide p. 74 of the TAC brief).

[66] The Appellant is a non-resident banking institution carrying on banking business in terms of the provisions of the Banking Act, No. 30 of 1988 (as amended). Section 86 of the Banking (Amendment) Act, No. 30 of 1988 defines a banking business as follows:

> *"Banking business means the business of receiving funds from the public through the acceptance of money deposits payable upon demand by cheque,*

draft, order or otherwise, and the use of such funds either in whole or in part for advances, investments or any other operation either authorized by law or by customary banking practices".

[67] Section 6 of the Banking Act, No. 30 of 1988 (as amended) provides that no commercial bank shall carry on any banking business other than business specified in the licence. It reads as follows:

"6(1) Subject to the provisions of section 17, no licensed commercial bank shall:

(a) carry on any banking business other than the business specified in the license; or
(b) carry on any other business other than those specified in Schedule 11 to this Act".

[68] At the hearing on 28.11.2022, Mr. Ameen stated that the interest is the core business of the Appellant, but the interest income can be separated from its other business activities and therefore, the Appellant's interest income falls under section 3(e). Mr. Balapatabendi, however, submitted that the Appellant's interest income is associated with its banking business and therefore, it cannot be separated from its other branches.

[69] It is not in dispute that the Appellant is a licensed commercial bank to which a licence has been issued under the provisions of the Banking Act, No. 30 of 1988 (as amended) for carrying on banking business as defined in section 86 of the said Act. In terms of item 17 of Schedule 1 of the said Act, the Appellant Bank is listed as a licensed commercial bank under section 2(3) of the said Act. In terms of the definition of banking business, the Appellant bank is entitled to engage in the following business activities *inter alia*:

1. receiving deposits from the public and paying money upon demand;
2. issuing fixed deposits;
3. providing loans and advances with interest;
4. accepting, discounting, buying, selling, collecting and dealing in bills of exchange;
5. the purchasing and selling of bonds, scripts or other forms of securities on behalf of constituents or others;
6. investments in treasury bonds;
7. investment in development bonds issued by the Central Bank of Sri Lanka;
8. other financial services.

[70] According to the financial statement of the Appellant, the Appellant provides a comprehensive range of financial services encompassing corporate, personal, trade, finance, treasury and investment services (p. 55 of the TAC brief). The Appellant's argument is that (i) the interest earned by the Appellant in granting loans to the Government of Sri Lanka, investment in Government Development Bonds and with other banks is a source under section 3(e); (ii) interest receipts of the Appellant can be separated from the rest of the business and therefore, interest is a source under section 3(e); and (iii) accordingly, the special provisions relating to interest under section 9 should apply to interest earned by the Appellant.

[71] According to the financial statement of the Appellant, the Appellant has received income from a wide range of banking and financial activities such as:

1. Interest income
   (a) interest income from loans and advances to customers;
   (b) interest income from treasury bills and treasury bonds & placement with other banks;
   (c) interest income from debenture investment
2. Other income
   (a) income from discounts on bills;
   (b) income from net foreign exchange gain;
   (c) dividend income from securities;
   (d) fees and commission income;
   (e) profits on sale of fixed deposits;
   (f) other income.

[72] According to the financial statement of the Appellant, the Appellant has incurred expenses from the following banking and other financial activities:

1. Interest expenses
   (a) Deposits from customers;
   (b) Borrowing from banks.
2. Operating expenses
   (a)Auditor's remuneration;
   (b) depreciation;
   (c)financial VAT;
   (d)EPF & ETF
   (e)litigation
   (f)other

[73] In my view, the income of the Appellant from its banking business which includes dealing with deposits, borrowing, loans, investment, commission, discounts, sale of fixed deposits, securities, and other connected banking activities is income from the same source and whatever accrues in the form of interest, whether from securities, or loans or investment. It would fall under section 3(a) unless it can be clearly separated from its banking business because all the interest accrues from the business carries on by the Appellant is only one banking business, with several branches.

[74] It is manifest that the interest earned by the Appellant is not its sole business, and its income is not derived from interest alone. The Appellant has received income from loan and advances, treasury bills and treasury bonds, debenture investment and other income including dividends, commission discounts, foreign exchange gain, and sale of fixed deposits etc. During the course of the submissions made on 28.11.2022, Mr. Ameen admitted that the Appellant's core business is the interest income earned from its banking income, but submitted that interest income has been separated from the audited statement of accounts and therefore, it has been separately identified.

[75] Had the earning of interest been the sole or separate business of the company, then, the interest alone stands on a separate footing and falls within the term "interest" under section 3(e) of the IRA. If it falls under section 3(e), special deduction rule in section 25(1)(f) read with 25(4), subject to section 26 would apply to expenses. In other words, if the interest is not sole or separate business of the Appellant, it would fall within the words "profits from any business" under section 3(a) of the IRA. In such case, the ordinary rule of deduction under section 25(1) would apply to outgoings and expenses.

[76] That matter does not end there. The issue here is the application of the tax exemption under section 9 of the IRA 2006 where the income falls either within the meaning of section 3(a) or 3(e) of the IRA. I will be shortly dealing, in this judgment, with the applicability of tax exemption under section 9 where the profits and income falls under section 3(a) of the IRA 2006.

[77] It is manifest that the business of the Appellant does not consist in the receipt of dividends, interest or discounts alone and its earning consists of several other sub-sources of core business activities. Applying the first part of the test 81dopted by Howard C.J. and Keuneman J., the Appellant would not fall within the ambit of the first element of the test and therefore, section 3(e) would not apply to the Appellant under the first element.

[78] I will now turn to the second element of the test. The Appellant however, relies on the second part of the test adopted by Howard C.J. and Keuneman J. and argues that section 3(e) applies on the basis that interest received by the Appellant can be clearly separated from the rest of the business and the interest received has been separately quantified for the purpose of tax liability.

[79] A perusal of the financial statement reveals that the Appellant carried on one banking business, which consists of several branches, viz, the earning of interest, dividends, commission, discounts, sale of fixed assets, foreign exchange gain etc. The business income from such branches is derived by the Appellant by using the funds collected from the depositors through the acceptance of money deposits for loans, advances, investments or any other operations authorized by law and by customary banking practices.

[80] The Appellant is not an investment company like in the case of CFI case. There is nothing to indicate that the interest was earned by the Appellant solely from a capital investment made by the Appellant, which has no connection whatsoever, with the funds received by the Appellant from the public through the acceptance of money deposits, or that a capital investment alone was used for all investment or granting loans to customers or the Government of Sri Lanka. A banker thus derives its income for its business as a banker and it does not acquire another source of income if part of the capital employed in the business is held in the form of securities. The interest he received for the securities is income from the business of banking (*Huges v. Bank of New Zealand* 21 TC 472). The interest received by a bank on overdrafts or loan accounts or investment by employing moneys employed in the banking business are receipts of the banking business, and therefore, they cannot be classified as a separate business carried out by the Bank.

[81] It is clear from the financial statement of the Appellant that the interest is embedded in the banking business of the Appellant and thus, it cannot be separated from the ordinary banking business of the Appellant. The mere reference to separate entries in the audited statement of accounts, in the absence of separate accounts maintained by the Bank cannot show that the Appellant carried on a separate business, and derived interest income only from such business, which is not embedded in the banking business of the Appellant.

[82] On the facts and circumstances of the case, I am of the opinion that the interest earned by the Appellant cannot be regarded as the sole or separate business of the Appellant. I am of the view that the income derived by the

Appellant from interest cannot be separated from the profits earned by the Appellant from its banking business, as it is embedded in its banking business activities. I accordingly hold that in the present case, the income derived by the Appellant from interest falls within the words "profits from business" under section 3(a) of the IRA 2006. I do not find any force in the argument of Mr. Ameen that the interest income earned by the Appellant Bank falls within the term "interest" under section 3(e) of the IRA 2006.

Is the Appellant disentitled to the exemption under section 9 where the income earned falls within the words "profits from business" under section 3(a)?

[83] It was the initial contention of Mr. Ameen that as the interest income in question falls within the meaning of section 3(e), such interest income should be exempt in terms of section 9(b) and 9(d) of the IRA 2006. At the hearing on 28.11.2022, Mr. Ameen however, drew our attention to the stand taken by the Appellant's Representative, Mr. Jayanethi, before the TAC (p. 153 of the brief) that the treatment of interest as business profits does not preclude the grant of exemption to the Appellant since the interests contemplated in sections 9(b) and 9(d) are falling to be treated as business profits. The contention of Mr. Balapatabendi was however, that where the interest in question falls within the meaning of section 3(a), the exceptions under section 9 are not applied to the Appellant.

[84] Now the question is whether the exemption claimed by the Appellant under section 9 applies to the source of profits and income earned by the Appellant under section 3(e) of the IRA 2006 only, or where the source of income falls exclusively under section 3(a), the exemption under section 9 is inapplicable to the Appellant. In other words, the question is whether, the classification of the interest as business profits under section 3(a) precludes the Appellant from claiming the benefit to the exemption under section 9 of the IRA 2006.

[85] The TAC in its determination referred to section 107(3)(c) of the IRA 2006 and held that the nature of the business of the Appellant falls exclusively under section 3(a) and not under section 3(e), the Appellant is not entitled to claim the exemption under section 9(b) unless specifically excluded by any other provisions of the IRA 2006. The second is that the TAC decided that the Its findings at page 128 of the TAC brief reads as follows:

"It is an accepted fact that the interest received by the Appellant Bank from its core business activity is treated as £turnover" of the said bank. Hence, the interest received by the Appellant bank during the relevant period falls into the term "turnover" as defined in section 107(3)(c) of the Inland Revenue Act. Therefore, according to the nature of business of the Appellant bank, its profits fall exclusively under section 3(a) and does not fall under section 3€. In the above circumstances, the Appellant bank should be treated as carrying on the business of banking and therefore investments in government development bonds and the foreign currency loan granted to the government of Sri Lanka to earn interest has to be treated as part of the banking activity. Therefore, the Appellant bank is not entitled to claim exemption under section 9(b) of the Inland revenue Act. Further, exemption under section 9(b) will not be applicable to interest derived by the bank, since such income is derived as business income and it is liable to tax, unless specifically excluded by any other provision of the Inland Revenue Act".

[86] Section 2 (1) of the IRA provides that income tax shall, subject to the provisions of this Act, be charged at the appropriate rates specified in the First, Second, Third, Fourth and Fifth Schedules to this Act ….in respect of every person for that year of assessment. Section 3 which enumerates the sources of income chargeable to income tax and all income from whatever source derived is therefore chargeable to income tax.

[87] The income chargeable to tax enumerated in section 3 is the rule and the exemptions granted are exceptions to the rule. The use of the words "Income tax shall, subject to the provisions of this Act" in section 2(1) means that the income from whatever source derived is subject to the provisions of the IRA 2006, which signifies that the income chargeable with tax in section 3 is subject to the exceptions under section 9 of the Act. It would make the words "income tax shall, subject to the provisions of this Act" no meaning, if section 9 can only be engaged where interest is attributable to section 3(e) alone. If that the true meaning, no exemption is permissible from interest income under section 9 where the income falls within the meaning of section 3(a), and if so, the exemption in section 9 is meaningless.

Exemptions under section 9 of the IRA 2006

[88] A perusal of the TAC determination reveals that it has taken the view that only the interest income derived from a source under section 3(e) falls within the exemption under section 9, and that the exemption was not available in regard to income derived from banking business under section 3(a). The

legislature has however, *inter alia*, allowed the following interest accrued to any person outside Sri Lanka to be exempted from income tax:

> The interest accruing to any person outside Sri Lanka, from any security, note or coupon issued by the Government of Sri Lanka in respect of a loan granted in foreign currency 9(b) to the Government of Sri Lanka for its economic progress.

[89] It may be noted that when the receipt of income of a particular kind is exempted from tax, the exemption attaches to such receipts irrespective the source from which the receipt is derived (Gooneratne, Income Tax of Sri Lanka, 2nd Ed. p/ 176). The exemption from tax of interest in section 9 makes a distinction between an individual and a body of persons (supra). All income from whatever source derived is therefore, is chargeable to income tax subject to exceptions set out in sections 7-24 of the IRA.

Effect of section 99 of the IRA 2006

[90] The view of the TAC seems to be that only the interest income derived from a source under section 3(e) falls within the exemption and that the exemption was not available in regard to income derived from banking business under section 3(a). At the hearing, Mr. Balapatabendi, relies on section 99 of the IRA and submitted that when the source of income falls within the meaning of section 3(a), the exceptions under section 9 have no application. Section 99 reads as follows:

> *"99. Where any provision of this Act expressly relates to any particular source of profits or income referred to in section 3, such provision shall not be applied in the determination of any profits or income arising from any other source referred to in that section".*

[91] According to the scheme of the IRA 2006, income tax has to be charged in respect of the "all profits and income" for that year of assessment of a person and "all profits and income" is defined under section 2(1) to comprise all "profits and income" or "profits" or "income" from whatever source derived from the heads specified in section 3, subject to certain exemptions. But what is significant is that profits and income or profits or income described in section 3 from whatever source derived is that section 3 is intended as describing different kinds of profits.

[92] The combined reading of sections 2 and 3, and shows that income tax is to be charged at the rate or rates prescribed in the IRA 2006 on the "all profits and

income" of the person as defined in section 2(1) of the IRA 2006 and computed from the "all profits and income" of such person in the words of Viscount Dunedin in *Salisbury House Estate v. Fly* (1930) 15 T.C. 266:

> *"Now, the cardinal consideration in my judgment is that the income tax is only one tax, a tax on the income of the person whom it is sought to assess, and that the different schedules are modes in which the Statute directs this to be levied".*

[93] Viscount Dunedin, J. further stated that "there are no separate taxes under the various schedules but only one tax. But in order to arrive at the total income on which tax is to be charged, you have to consider the nature, the constituent parts, of his (assessee's) income to see which schedule you are to apply". Sir George Rankin in *Commissioner of Income Tax v. Chunilal B. Metha* (1938) 6 I.T.R. 521, further said:

> *"The effect of section 6 is to classify profits and gains, under different heads for the purpose of providing for each appropriate rules for computing the amount, its language is "shall be chargeable….in the manner hereinafter appearing".*

[94] These words are useful to consider under what head it appropriately and specifically falls, and if it falls under one particular head, then computation is to be made under the section which covers that particular head of income to which the particular tax rate applies. Thus, each head refers to income or profits attributable to the source –(i) trade, business, profession or vocation, employment, dividends, interests, discounts employment, rents, royalties etc. This supports the contention of each head being separate, exclusive and specific. However, it refers to the income of the person whom it is sought to assess, and such different heads are modes in which the Statute directs this to be levied according to the different rates, subject however, to exemptions.

[95] As Viscount Dunedin, J. held in *Salisbury House Estate v. Fly* (supra), the list of heads in section 3 contains a list of sources and one source is distinct from another source. He further held that there are no separate taxes under the various heads but only one tax, and the different heads are modes in which the Statute directs profits and or income is to be levied according to the different rates, subject however, to exemptions granted by the Act. Where the profits and income or profit or income expressly falls within any particular source under section 3(a), such source applies to the determination of such profits and income, or profit or income under that source and none other is the principle behind

section 99 and nothing more. In the result the assessor or the taxpayer has no option to elect the head under which the profits and income or profit or income can be determined by bringing it under any other head in section 3 of the IRA. This view is further fortified by the following statement of law contained in Volume 1 of Simon's Income Tax (1948 Ed.) p. 54:

> *"These schedules are prima facie mutually exclusive and consequently if a particular kind of income is charged under one schedule, the Crown cannot elect to charge it under another"*.

[96] There is support for this proposition from the CFI judgment itself. In the CFI case, the attention of the Court was brought to section 47 of the Income Tax Ordinance, 1932, which is corresponding to section 99 of the IRA 2006. Section 47 of the Income Tax Ordinance, 1932 reads as follows:

> *"Where any provision expressly relates to any particular source of profits or income mentioned in sub-section (1) of section 6, such provision shall not apply to the determination of any profits or income which is assessable and has been assessed as falling within any other source mentioned in that sub-section"*.

[97] His Lordship Keuneman J. referring to section 47 of the Income Tax ordinance, and the test applied to identify in what circumstances, dividends, interest or discount could fall within the ambit of section 6(1)(a) or 6(1)(e) rejected the argument of the Crown that the assessor has an option to choose between the various sources under section 6(1). His Lordship stated that the Crown has no option to elect between various sources under section 6 and charge the tax accordingly. Thus, the question whether dividends, interest or discount could fall either within section 6(1)(a) or 6(1)(e) will depend on the basis of the CFI test and not on the basis of any option elected by the assessor or the assessee. His Lordship Keuneman J., after formulating the test stated at p. 20:

> *"In my opinion, section 47 lends support to this. Section 47 applies to provisions expressly relating to any particular source under section 6(f) to that source and to none other"*.

[98] It seems to me that where the interest earned is separate and distinct head under section 3(a) and if a profit or income is chargeable under that head, it is not open to the assessee to change the head, or to the assessor to charge the tax under a different head. It is not possible to contend that where income falls under more than one head and say that the assessee has the option to choose

the head which makes the burden on his shoulders lighter and rely on the other source.

[99] The intention of the legislature in introducing section 99 is to recognize the principle that (i) each head of income of which source has its characteristics for income tax purposes and falls under one specific head under section 3 of the Act; and (ii) where any item falls specifically under one head, it has to be charged under that head and no other. In other words, the principle under section 99 is intended to deny any option to the assessee or the assessor to elect any particular head under section 3 and prevent the assessor to charge the tax on any of the sources which may be chosen by the assessor because each head being, specific to cover the item arising from a particular source.

[100] Both precedent and on a proper construction of the scheme of the Act, the income from interest would fall under section 3(a) as it is chargeable within the terms "profits from business" and therefore, it cannot be brought under a different source [(section 3(e)]. This would mean that once an activity is properly characterized as a business, trade or profession or vocation under section 3(a), such characterization cannot be changed by the taxpayer, assessor and brought under a different source referred to in section 3 for the purpose of determination of profits or income of such person. The principle in section 99 is important in computing profits from a specified source in section 3 since a particular taxing rule will apply exclusively to that rule, and it cannot be brought under a different provision in section 3 to which a different rule applies.

[101] The rule in section 99 is not intended to deny the exemption granted to an assessee where his source falls within the words "profits from business, trade, profession or vocation" under section 3(a) and allow the exemption only where his source falls within the terms "dividends, interest or discount". Such an interpretation is absurd and mischievous to the true intention of the legislature expressed in the IRA 2006. It permits the assessor to charge the tax on all profits and income from whatever source derived subject, however, to the provisions of the Act, which includes tax exemptions.

[102] Silke on South African Income Tax, 3rd Ed. P.123 explains the nature of exempt income in a taxing statute as follows:

> *"Exempt income is simply income that is free or immune from tax in the same way as receipts or accruals of a capital nature, but there is a fundamental distinction between the two. A capital receipt completely lacks the quality of income and does not form part of the gross income except in*

certain exceptional cases. Except income on the other hand, by its very nature is included in the gross income, but does not form part of the "income"

[103] In my view, having regard to the intention of the legislature expressly granting an exemption under section 9 of the IRA 2006, the proposition enunciated by the TAC that unless the Appellant falls within the term "interest" under section 3(e), it would not be entitled to the exemption under section 9 is manifestly wrong and I reject that proposition of the TAC.

[104] For those reasons, I am of the opinion that the application of section 9 is not dependent upon the source of income under which interest received is classified. Accordingly, I hold that the exemptions under section 9 of the IRA 2006 are applicable to a taxpayer from whatever sources derived, notwithstanding a company's interest income falls under section 3(a) or 3(e), **subject however, to other conditions** set out in section 9.

Applicability of section 9(b) to any person partnership outside Sri Lanka

[105] Now the question is whether the conditions set out in the exception claimed by the Appellant under section 9(b) have been satisfied by the Appellant to be eligible for the above-mentioned exception. The Appellant claims that the interest income of Rs. 107,415,575/- accrued to it on foreign currency loan granted to the Government of Sri Lanka upon Government security issued by the Government of Sri Lanka is exempt from income tax under section 9(b) of the IRA 2006. Section 9(b) reads as follows:

"9(b) The interest accruing to any person or partnership outside Sri Lanka, from any security, note or coupon issued by the Government of Sri Lanka in respect of a loan granted in foreign currency by that person or partnership to the Government of Sri Lanka, if such loan is-

(i) Granted prior to April 1, 2002, and approved by the Minister as being essential for the economic progress of Sri Lanka, or

(ii) Granted on or after April 1, 2012".

Conditions for the exemption under section 9(b)

[106] The interest accruing to any person under section 9 (b) is exempt from tax, provided that the following conditions are satisfied by such person:

1. The interest accrued to any person or partnership outside Sri Lanka;

2. The interest accrued to such person from any security, note or coupon issued by the Government of Sri Lanka;
3. The said Security should have been issued in respect of a loan granted in foreign currency by that person or partnership to the Government of Sri Lanka;
4. The said loan was granted prior to April 1, 2012;
5. The said loan was approved by the Minister as being essential for the economic progress of Sri Lanka.

Does the exemption under section 9(b) apply only to an individual?

[107] It is significant to consider whether the exemption from tax on interest in section 9(b) applies only to an individual as opposed to a person. A perusal of section 9 of the IRA reveals that the exemption applies to the following persons, company, partnership or other body of persons:

1. **a company or partnership or other body of persons outside Sri Lanka** is given exemption from tax on interest coming within paragraph (a) of section 9;
2. An **individual** is given the exemption from tax on interest that comes within paragraph 9(h) and 9(i);
3. **All persons** are given exemption from tax on interest coming within paragraphs (c), (d), (e), (f) and (g).

Who is a "person" within the meaning of the IRA 2006?

[108] On the face of the relevant provisions of section 9, it is crystal clear that the exemption in section 9(b) applies to "any person" or "partnership" and the word "individual" is not used in section 9(b). The word "individual" is used only in section 9(h) and 9(i) of the IRA 2006. If the intention of the legislature is to limit the application of section 9(b) to an individual, it could have easily used the word "individual" instead of using the word "person". Section 9(b) applies to "any person" and the word "person" is defined in section 217 as follows:

"person" includes a company or body of persons or any government".

[109] Section 86(c) of Banking (Amendment) Act, No. 2 of 2005 defines a "company". "Company" means a company formed and registered under the Companies Act, No. 17 of 1982 and **any other body incorporated within or outside Sri Lanka**". However, the IRA 2006 defines a "company" and a

"company" includes a company incorporated or registered under any law in Sri Lanka or elsewhere. A "company" is defined in section 217 often IRA as follows:

> *"Company means any company incorporated or registered under any law* ***in force in Sri Lanka or elsewhere****, and includes a public corporation".*

[110] Section 86(c) of Banking (Amendment) Act, No. 2 of 2005 defines a "company" as follows:

> *"Company" means a company formed and registered under the Companies Act, No. 17 of 1982 and any other body incorporated within or outside Sri Lanka".*

[111] A body of persons is defined in section 217 of the IRA as follows:

> *"Body of persons" includes any local or public authority, anybody corporate or collegiate, any fraternity, fellowship, association or society of persons, whether corporate or unincorporated, and any Hindu undivided family, but does not include a company or a partnership".*

[112] It seems to me that the Appellant who is a company incorporated outside Sri Lanka and operating through a permanent establishment is a "person" within the meaning of section 9 (b) of the IRA read with section 217 of the IRA 2006.

[113] Section 28(1) of the IRA 2006 which relates to the basis for the ascertainment and computing the total statutory income uses the word "person" as follows:

> *"28(1). The statutory income of* ***every person*** *for each year of assessment from every source of* ***his*** *profits or income in respect of which tax is chargeable, shall be the full amount of the profits or income which was derived by* ***him*** *or arose or accrued to his benefit from such source during that year of assessment, notwithstanding that he may have ceased to possess such source or that such source may have ceased to produce income".*

[114] The only issue is whether the words "his" or "he" in section 28(1) applies only to an individual and not to a company or a bank. In the Blacks' Law Dictionary (11th Ed.) The word "he" is defined as follows:

> *"Properly a pronoun of the masculine gender, traditionally used and constructed in statutes to include both sexes* ***as well as a corporation****".*

[115] In the Law Lexicon Dictionary (2nd Ed.), the word "He" is defined as follows:

> *"The pronoun "he" when used in any Code, includes a female as well as a male, unless there is some express declaration to the contrary. The word*

*"he", when used **in the Revenue act,** includes male, female, **company, corporation, firm, society, singular or plural number**".*

[116] The use of the word "person" in section 9(b) reflects the intention of the legislature that the legislature intended to apply the exemption to any "person" or "partnership", instead of any "individual" as correctly submitted by Mr. Ameen.

Does a "person" in section 9(b) or (d) exclude a bank?

[117] The next question is whether the word "person" in section 9(b) excludes a bank as the word "bank" is not specifically stated in section 9(b). It is relevant to note that section 2 of the Banking Act, No. 30 of 1988, relates to the licensing of **persons** carrying on banking business, and in terms of section 2(4), the Appellant Bank had been issued with a licence to carry on banking business as a commercial bank in Sri Lanka as set out in Schedule I of the said Acy (vide-item 17 of the Schedule). The long title of the Banking Act, No. 30 of 1988 reads as follows:

"An Act to provide for the introduction and operation of a procedure for the licensing of persons carrying on banking business and of carrying on the business of accepting deposits and investing such money; for the regulation and control of matters relating to such business; and to provide for matters connected therewith or incidental thereto".

[118] Section 2 of the Banking (Amendment) Act, No. 33 of 1995 replaced the long title of the Banking Act, No. 30 of 1988 and inserted the following long title:

"An Act to provide for the introduction and operation of a procedure for the licensing of persons-carrying on the banking business and of carrying on the business of accepting deposits and investing such money; for the regulation and control of matters relating to such business; and to provides for matters connected therewith or incidental thereto".

[119] It seems to me that there is no any major difference of the long title between the Banking Act, No. 30 of 1988 and the Banking (Amendment) Act, No. 33 of 1995. There is nothing to indicate in the language of section 9(b) or 9(d) that its application is limited to a company, which is not a company carrying on banking business in Sri Lanka through a permanent establishment when the definition of the "company" under section 86(c) of the Banking (Amendment)

Act, No. 2 of 2005 includes a "company" formed and registered under the Companies Act, No. 17 of 1982 and any other body incorporated within or outside Sri Lanka. It is crystal clear that the Appellant commercial bank is a company both within the meaning of the Banking Act (as amended) and the IRA 2006 and therefore, it falls within the meaning of a "person" under section 217 of the IRA 2006.

[120] It is settled law that courts cannot usurp legislative function under the disguise of interpretation and rewrite, recast, reframe and redesign the Inland Revenue or add words to a provision, which are not contained therein, because this is exclusively in the domain of the legislature. In R. *v. Wimbleton Justices EX. P. Derwent* (1953) 1 Q.B. 380, at 384, it was held that "a Court cannot add words to a statute or read words into it which are not there". In *Fernando v. Perera* 25 NLR 197, Jayawardene J. observed at p. 200 stated that "Courts have no power to add to the language of a Statute, unless the language as it stands is meaningless or leads to an absurdity". This proposition was lucidly explained by Lord Simonds in *Magor and St Mellons Rural District Council v. Newport Corporation* [1952] AC 189, HL. Referring to the speech of Lord Denning MR, Lord Simonds said at page 191:

> *"The duty of the court is to interpret the words that the legislature has used; those words may be ambiguous, but, even if they are, the power and the duty of the court to travel outside them on a voyage of discovery are strictly limited."*

[121] MR, Lord Simonds further said at page 192:

> *"It appears to me to be a naked usurpation of the legislative function under the thin disguise of interpretation and it is the less justifiable when it is guesswork with what material the legislature would, if it had discovered the gap, have filled it in. If a gap is disclosed, the remedy lies in an amending Act".*

[122] The same proposition was echoed by Arijit Pasayat, J. in the Indian Supreme Court case of *Padmasundara Rao and Others. v. State of Tamil Nadu and Others.* AIR (2002) SC 1334, at paragraph 14 as follows:

> *"14. While interpreting a provision the Court only interprets the law and cannot legislate it. If a provision of law is misused and subjected to the abuse of process of law, it is for the legislature to amend, modify or repeal it, if deemed necessary".*

[123 In *Cape Brandy Syndicate v. I.R.C.* [1921] 1 KB 64 at 71 (Ch D) that: (1921) Rowlatt J. stated:

> *"In a taxing Act, one has to look merely at what is clearly said. There is no room for any intendment. There is no equity about a tax. There is no presumption as to a tax. Nothing is to be read in, nothing is to be implied, one can only look fairly at the language used"*.

[124] The Appellant is a company incorporated in India and operating through a permanent establishment in Sri Lanka, and is liable to income tax in terms of section 2 and 97 of the IRA 2006 read with Article 6 of the DTAA between India and Sri Lanka. The Appellant being a company both within the meaning of the Banking Act (as amended) and the IRA 2006 is a person to whom the tax exemption applies under section 9(b) and 9(d) of the IRA 2006.

Is the Appellant a person outside Sri Lanka?

[125] The TAC has disallowed the exemption under section 9(b) on the ground that the Appellant is not a person outside Sri Lanka and accordingly, the Appellant is not entitled to claim the exemption under section 9(b). The findings of the TAC at page 6 of the determination are as follows:

> *"The Indian Overseas Bank, Colombo branch is operating under a license granted in terms of section 5 of the Banking Act, No. 30 of 1988, to function as a domestic banking unit in Sri Lanka. It is the said Indian Overseas Bank Colombo branch which has granted a foreign currency loan to the government of Sri Lanka. The Indian Overseas Bank branch is therefore, not a person outside Sri Lanka, to qualify for the interest exemption claimed under section 9(b) of the Inland Revenue Act, No. 10 of 2006"*.

[126] At the hearing, Mr. Ameen submitted that the said loan was arranged outside Sri Lanka by several banks and financial partners and the Appellant Bank and the Government of Sri Lanka entered into a Facility Agreement for granting a foreign currency loan to the Government of Sri Lanka for its economic progress. The said Facility Agreement is not available in the TAC brief. The assessor-Bank & Financial Services Unit has admitted in his Appeal report (p. 66 of the TAC brief) that a Loan Facility Agreement was signed between the Government of Sri Lanka and the Appellant with Standard Chartered Bank acting as agent. It is not in dispute that the Government of Sri Lanka and the Appellant-Colombo branch signed a Facility Agreement and in terms of the said Agreement, the Appellant granted a foreign currency loan to the Government of Sri Lanka for its economic progress.

[127] The assessor, Bank & Financial Unit has however, reported that the Appellant is not a person outside Sri Lanka and disentitled to the exemption since the Indian Overseas Bank-Colombo Branch is located at No. 139, Main Street, Colombo 11 (Vide-page 65 of the TAC brief). The next point is to consider whether the Appellant Bank (Indian Overseas Bank, Colombo Branch) having a permanent establishment in Sri Lanka is a "person outside Sri Lanka" for the purposes of the exemption under section 9(b) of the IRA 2006 by virtue of the application of Article 5 of the DTAA between India and Sri Lanka.

[128] A company is resident in Sri Lanka under section 79 of the IRA 2006 where it has its registered or principal office in Sri Lanka or where the control and management of the business are exercised in Sri Lanka. Non-resident company in Sri Lanka means a company not falling within the meaning of section 79. Thus, the place of registration or place of principal office or the place of central management and control are the sole test of a company's residence.

[129] The concept of permanent establishment is relevant for assessing the income of a non-resident under the provisions of the DTAA between India and Sri Lanka. By virtue of Article 7 (1) of the DTAA, the business income of companies which are incorporated in India will be taxable only in India, unless it is found that they have permanent establishments (PE) situated in Sri Lanka. In such event, their business income may be taxable to the extent to which it is attributable to such PEs, would be taxable in Sri Lanka. The word "permanent establishment" is of course, a concept created by the DTAA for tax purposes, and it can be described as a taxable entity which is commonly used in all international Double Taxation Avoidance Agreements,

[130] Article 5 (1) of the DTAA defines the term "permanent establishment" as a "fixed place of business of an enterprise is wholly or partly carried on". It reads as follows"

> *"1. For the purposes of this Convention, the term "permanent establishment" means a fixed place of business through which the business of the enterprise is wholly or partly carried on".*

[131] Article 5 (2) describes what permanent establishment includes. It reads as follows:

> *"2. The term "permanent establishment" shall include especially:*
>
> *(a) a place of management;*

(b) a branch;

(c) an office;

(d) a factory;

(e) a workshop;

(f) a mine, an oil or gas well, a quarry or any other place of extraction of natural resources; (g) an agricultural or farming estate or plantation;

(h) a building site or construction or assembly project which exists for more than 183 days;

(i) the furnishing of services, including consultancy services, by an enterprise through employees or other personnel, where activities of that nature continue within the country for a period or periods aggregating more than 183 days within any twelve-month period".

[132] The fundamental principle of the DTAA is that for the application of the DTAA, a person, whether an individual or company from one country (Country "A") will be taxable in the other country (Country "B") only if he has a permanent establishment (PE) in Country "B". Thus, if there is a PE, only the income attributable to such PE in Country "B" will be subject to tax in Country "B". Accordingly, a non-resident company will be liable to income tax in Sri Lanka if it carries on a trade in Sri Lanka through a permanent establishment (i.e., a branch or agency)

[133] It may be noted that the concept of permanent establishment is relevant for assessing the income of a non-resident under the DTAA but the concepts profits of business connection and permanent establishment should not be mixed up. While the business connection is relevant for the purpose of application of Sections 2 and 3, the concept of permanent establishment is relevant for assessing the income of a non-resident under the DTAA

[134] The Appellant is the Indian Overseas Bank, Colombi branch. It is not in dispute that the Appellant is incorporated in India and is resident in India. It is not in dispute that the Appellant a non-resident (foreign) company in Sri Lanka doing banking business through a permanent establishment in Sri Lanka. The Commissioner Mr. D. Ranagalle at page 97 of the TAC brief confirms this position as follows:

"It was revealed that the monetary Board of Sri Lanka has granted a licence to the Indian Overseas Bank of 763, Anna, Salai, Chennai 600002, India to carry on a domestic banking business at No. 139, Main Street, Colombo 11. So. ***Indian***

Overseas Bank Colombo branch (hereinafter referred to as "Bank) is non-resident company doing business in Sri Lanka through a branch."

[135] The Deputy Commissioner-Appeal Mr. M.P. Amaratunga, at p. 63 of the TRA brief states:

"The Indian Overseas Bank-Colombo branch is not limited liability company domiciled in Sri Lanka. It is a non-resident company doing business in Sri Lanka through a branch".

[136] I am of the view that the Appellant is a non-resident (foreign) company having a branch office in Sri Lanka and earning its profits and income from its business in Sri Lanka through a permanent establishment. The Appellant company can be treated as a permanent establishment (PE) with a registered branch office in Sri Lanka within the meaning of Article 5 of the DTAA between India and Sri Lanka. Accordingly, the Appellant company is subject to taxation in Sri Lanka, subject to any exemption or deduction, on the profits of a business carried on in Sri Lanka, through a permanent establishment located in Sri Lanka.

[137] However, it is only a branch of a foreign enterprise, which is resident in India, which is outside Sri Lanka. The fact that it has been granted a licence to conduct banking business in Sri Lanka does not change its legal status of a non-resident foreign company doing business in Sri Lanka. Thus, it will retain the residence of the parent company in India and so, it will be resident outside Sri Lanka for tax purposes, even though located within Sri Lanka through a PE.

[138] The TAC has interpreted the words "person outside Sri Lanka" to a person having a branch in Sri Lanka" merely because it has a branch in Sri Lanka, when the Appellant is only a branch of a foreign company, a resident in India, which is incorporated and located outside Sri Lanka. In my view the intention of the legislature is to encourage any person, which includes a non-resident (foreign) bank that grants foreign currency loans to the Government of Sri Lanka and exempt interest accrued on such banks from the interest derived from such loans, notwithstanding whether such company has a permanent establishment in Sri Lanka.

[139] In my view, a non-resident foreign company incorporated in India having a permanent establishment is a person outside Sri Lanka for the purposes of the IRA 2006. In this context, the exemption under section 9(b) applies to any person, which includes a non-resident (foreign) banking company, having a permanent establishment in Sri Lanka, that grants foreign currency loans to the Government of Sri Lanka for its economic progress. I hold that the exemption under section

9(b) applies to the Appellant who is a non-resident person and thus, the Appellant is a person outside Sri Lanka, notwithstanding whether such non-resident person has a permanent establishment in Sri Lanka.

[140] A tax exemption is granted by the legislature to provide relief to a person who would be otherwise liable to tax for the purpose of giving a measure of relief and thus, it must be given its full effect unless, the conditions for its fulfilment are not met. In *Nanayakkkara v. University of Peradeniya* (1991) 1 Sri LR. 97, at p. 102, S.N. Silva, J. as he then was) expounded this proposition in the following words:

> *"A necessary corollary of applying the rule of strict construction to determine liability under a taxing statute, is that any provision granting an exemption from such liability be given its full effect. Exemptions are provided for by the Legislature for the purpose of giving a measure of relief to a person who would otherwise be liable to tax under the general rule. Therefore, no restriction should be placed on such provision by way of interpretation so as to defeat the purpose of granting such exemption".*

[141] I am of the opinion that the Appellant is entitled to the benefit of the exception under section 9(b) of the IRA 2006 notwithstanding the profits and income derived from interest falls within the meaning of section 3(a) of the IRA, provided that the conditions stipulated in section 9(b) are fulfilled by the Appellant.

Exemption of interest income under section 9(b) on foreign currency loan granted to the Government of Sri Lanka

[142] In the present case, it is common ground that the Appellant had granted a foreign currency loan to the Government of Sri Lanka upon a security issued by the Government of Sri Lanka and an interest income of Rs. 107,415,575/- had accrued to the Appellant. It was never disputed by the assessor or the Respondent that the said loan was not granted to the Government of Sri Lanka for its economic progress and that it was not approved by the Minister in charge of Finance on behalf of the Government of Sri Lanka.

[143] The Appellant Bank is incorporated outside Sri Lanka. The Agreement had been arranged by several international banks, including the Standard Chartered Bank acting as an Agent. The lender of the facility is the **Indian Overseas Bank** incorporated in India and the loan was arranged by several overseas banks.

[144] It is undisputed, however, that the Legislature has clearly recognized that the interest accruing to any person outside Sri Lanka for granting a loan to the Government of Sri Lanka in foreign currency upon any security issued by the Government of Sri Lanka is exempt from tax under section 9(b) of the IRA 2006 subject to certain conditions.

[145] Exemption from tax under section 9(b) has been granted to encourage any non-resident person to provide a foreign currency loan to the Government of Sri Lanka for its economic progress upon a security issued by the Government of Sri Lanka for its economic progress, notwithstanding such a non-resident person carries on business in Sri Lanka through a permanent establishment (PE).

[146] In the present case, the following conditions set out in section 9(b) have been satisfied by the Appellant:

1. The Appellant granted a foreign currency loan to the Government of Sri Lanka, who issued a security in respect of such loan granted to the Government of Sri Lanka;
2. Interest income of Rs. 107,415,575/- accrued to the Appellant from the Government of Sri Lanka;
3. The said loan was granted prior to April 1, 2012;
4. The Minister in charge of Finance, on behalf of the Government of Sri Lanka approved the said loan as being essential for the economic progress of Sri Lanka.

[147] For those reasons, I am of the opinion that the Appellant is entitled to the exemption of interest income amounting to Rs. 107,415,575/- on foreign currency loan granted to the Government of Sri Lanka under section 9(b) of the IRA 2006.

Conclusion

[148] For those reasons, I answer questions of law arising in the case stated as follows:

1. No.
2. Yes. The opinion of Soertsz J. was that the question whether section 6(1)(a) or 6(1)(e) applies in a particular case depends on whether or not the assessor is dealing with the "profits of a business" or the "income of an individual". Soertsz J. held that where dividends, interest or discounts appertaining to a business, they fall within the words "profits of any business" and section 6(1)(a) apples. If, however, it is a case of dividends, interest or discounts accruing to an individual not in the course of a business, but as a part of his

income from simple investments, then section 6(1) (e) is the relevant section. Soertsz J. held that so far as interest is concerned, the special rule in section 9(3) modifies the general rule in section 9(1). Justice De Krester agreed with Justice Soertsz.

3. Yes.
4. (a) Yes

   (b) Howard C.J. said that if the business of a company consists in the receipt of dividends, interest or discounts alone, or if such a business can be clearly separated from the rest of the trade or business, special provisions under section 9(3) will apply to such dividends, interest or discounts. Kenueman J. also said if the business of a company consists in the receipt of dividends, interest or discounts alone, or if such a business can be clearly separated from the rest of the trade or business, then any special provisions under section 9(3) applies to such dividends, interest or discounts. As regards the deduction of management expenses incurred in relation to dividends, Kenueman J. held that management expenses had been incurred in the production of the income and are necessary and reasonable expenses, and can be deducted under section 9(1). As regards, the deduction of interest earned by the company, Kenueman J. held that where the earning of interest has been the sole and separate business of the company, the special provision in section 9(3) would apply and if not, the ordinary rule under section 9(1) of the Income Tax Ordinance would apply, and the deductions claimed can be allowed in their entirety.

5. Yes.
6. Yes
7. Yes (subject to the observations made in this judgment)

[149] For those reasons, I annul the determination made by the Tax Appeals Commission dated 28.06.2016 and the Registrar is directed to send a certified copy of this judgment to the Tax Appeals Commission.

JUDGE OF THE COURT OF APPEAL

M. Sampath K.B. Wijeratne, J.

I agree

JUDGE OF THE COURT OF APPEAL