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

In the matter of a case stated under reference No. TAC/IT/031/2016 by the Tax Appeals Commission under Section 170 of the Inland Revenue Act, No. 10 of 2006 read together with Section 11A (1) of the Tax Appeals Commission Act, No. 23 of 2011 (as amended)

LOLC Finance PLC,
No. 100/1, Sri Jayewardnepura Mawatha,
Rajagiriya.

Appellant

Case No. CA/TAX/0018/2019
Tax Appeals Commission
No. TAC/IT/031/2016

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.

: Maithri Wickremasinghe, P.C. with Rakitha Jayatunga for the Appellant

Milinda Gunatilleke, A.S.G with Sabrina Ahamed for the Respondent

Argued on : 07.04.2011 & 10.10.2022

Written Submissions filed on
: 05.12.2022 & 29.04.2021 **(**by the Appellant)

06.12.2022 & 28.10.2021 (by the respondent)

Decided on : 27.01.2023

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 21.05.2019 confirming the determination made by the Commissioner General of Inland Revenue on 07.01.2016 and dismissing the Appeal of the Appellant. The period relates to the year of assessment 2010/2011.

Factual Background

[2] The Appellant LOLC Finance PLC is an unquoted public limited company incorporated with its principal activities comprising of leasing and hire purchase, margin trading, pawn brokering, loans, property development, mobilization of private deposits and Islamic banking.

[3] The Appellant filed its returns for the year of assessment 2010/2011 claiming tax exemptions and deductions for notional tax credit, undeclared lease rentals, bad debts, doubtful debts, sale of pawning portfolio, gain on the sale of gold investment, gain on sale of government bonds and interest on treasury bills. With regard to the profits on sale of pawning brand, gold investment and bonds, the Appellant claimed that the gain on sale of the pawning brand, gold investment and bonds is a capital gain and not a profit from the sale and therefore, such gain is not taxable for income tax. The assessor by its letter dated 22.11.2013 refused to grant the said exemptions and deductions and issued the assessment accordingly.

Appeal to the Commissioner-General of Inland Revenue

[4] 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 07.01.2016 allowed the notional tax credit, capital portion of the lease rentals, bad and doubtful debts and interest on treasury bills, but disallowed the profits on the sale of brand, gold investment and bonds. The Respondent held in its reasons for the determination of the appeal that:

1. After the abolition of the capital gain from taxing statute, no capital gain is available in the Inland Revenue Act, No. 10 of 2006 (hereinafter referred to as the IRA 2006) and such gain or profit should be treated as “profits and income” or “profit” or “income” under section 3 (a) of the IRA 2006;

2. Any profit or gain earned by the Appellant from the sale of pawning brand, gold investment and bonds should be treated as "profits and "income" earned in the business activities of a finance company and, therefore, such gain or profits is liable for income tax under section 3(a) of the IRA 2006.

Accordingly, the Respondent revised the assessment made by the assessor in the following manner (p. 12 of the TAC brief):

		Rs.
Adjusted total statutory income	-	428,220,437
Add – Unreconciled lease rentals	-	6,296,889
Profit on sale of pawing portfolio	-	610,000,000
Profit on sale of gold investment	-	50,222,075
Profit on sale of bond	-	278,811,854
Adjusted taxable income	-	1,373,551,255

Appeal to the Tax Appeals Commission

[5] 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 21.05.2019 that after the abolition of capital gain, any gain or profit received by a person should be treated as profits from any trade or business and therefore, the gain received by the Appellant should be considered as income falling under section 3(a) of the IRA 2006, and dismissed the appeal. The relevant parts of the TAC determination at page 185 of the TAC brief read as follows:

> *"It is to be noted that, after the abolition of capital gain from the taxing Statute, any gain or profit received by a person should be treated as profits from any trade or business. The concept as capital gain is not available under the Inland Revenue Act. Therefore, the gain received by the Appellant from the sale of the brand, gold investment and the sale of treasury bonds should be considered as income falling under section 3(a) of the Inland Revenue Act".*

Appeal to the Court of Appeal & Questions of Law

[6] 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. Has the Tax Appeals Commission erred in law in failing to consider that the legislature has excluded "capital gains" from the meaning of "profits and income" or "profits" or "income" for the purpose of the Inland Revenue Act, No. 10 of 2006 and/or decided not to include capital gains

within the meaning of “profits and income” or “profits” or “income” for the purpose of the Inland Revenue Act, No. 10 of 2006?

2. Has the Tax Appeals Commission erred in law in failing to determine that “capital gains” is not chargeable with Tax under the Inland Revenue Act, No. 10 of 2006?

3. Has the Tax Appeals Commission erred in law in determining that after the abolition of capital gain from the taxing statute, any gains or profits received by a person should be treated as profits from a trade or business under the Inland Revenue Act, No. 10 of 2006?

4. Has the Tax Appeals Commission erred in law in determining that the concept of capital gain is no longer available under the Inland Revenue Act, No. 10 of 2006 and therefore, the gain received by the Appellant from the sale of the brand, gold investment and the sale of treasury bonds should be considered as income falling under Section 3 (a) of the Inland Revenue Act?

5. Has the Tax Appeals Commission erred in law in determining that the gain of Rs. 610,000,000/-which has been derived by the Appellant from the disposal of its pawning brand and goodwill is income falling under Section (a) of the Inland Revenue Act, No. 10 of 2006?

6. Has the Tax Appeals Commission erred in law determining that the gain of Rs. 50,222,075/- which has been derived by the Appellant from the disposal of investment in gold is income falling under Section 3 (a) of the Inland Revenue Act, No. 10 of 2006?

7. Has the Tax Appeals Commission erred in law in determining that the gain of Rs. 278,811,854/- which has been derived by the Appellant from the disposal of its investment in treasury bills and bonds is income under Section 3 (a) of the Inland Revenue Act, No. 10 of 2006?

[7] At the hearing of the appeal, we heard the learned President’s Counsel for the Appellant Mr. Maithri Wickremasinghe and the learned Additional Solicitor General for the Respondent Mr. Milinda Gunatilleke. Mr. Maithri Wickremasinghe submitted that the determination of the TAC is erroneous for the following reasons:

1. The TAC erred in law when it held that after the abolition of capital gain from the taxing statute, any gain or profit received should be treated as profits from any trade or business, and therefore, the capital gain received by the Appellant from the sale of brand, gold investment and

sale of treasury bonds should be considered as income falling under section 3(a) of the IRA 2006;

2. The TAC erred in not considering that a capital gain is not a receipt that falls within "profits and income" as defined in section 3 of the IRA 2006, and as such capital gain arising from the sale of brand, gold investment and sale of treasury bonds is not liable to income tax under the IRA 2006;

3. The TAC erred in not considering that it is only a profit that falls within section 3 of the IRA 2006 that is chargeable with income tax, and it is not every profit of a company that is liable for income tax;

4. The TAC failed to consider that a capital gain arising after 31.03.2002 should not be liable to income tax as the capital gain was not included within the definition of "profits and income" or "profits" or "income" in the IRA 2006, which applied to the year of assessment 2010/2011 relevant to this appeal;

5. The TAC failed to consider that the sale of the pawning portfolio and gold investment is a capital gain, and the profit generated from the sale of such investment is not income under section 3(a) of the IRA 2006;

6. The TAC failed to consider that the treasury bonds are financial assets of the Appellant and the Appellant invested in purchasing treasury bonds for earning an income from the interest derived from them, and therefore, the TAC failed to consider that the Appellant was not involved in buying and selling treasury bonds in the course of its business activities.

[8] On the other hand, Mr. Milinda Gunatilleke submitted that the TAC was correct in dismissing the appeal filed by the Appellant for the following reasons:

1. The profits received from the sale of brand, gold and treasury bonds fall within the ambit of trading profit which is liable to tax, and in the absence of an express exemption of capital gain from the application of the charging section, the profits earned from the sale of brand, gold investment and treasury bonds will become liable to tax as trading income or trading profits under section 3(a) of the IRA 2006;

2. The Appellant's Accountants Ernst & Young has classified the income from the sale of the pawning brand as "profits" on pawning portfolio sale" and not as a capital gain, and where trading profits are not expressly exempted from income tax, the profits derived from the sale of brand, gold investment and treasury bonds become chargeable to tax;

3. The pawn brokering business and the gold investment are main business activities of the Appellant and they are trading assets of the Appellant and thus, the gain made by the Appellant from the sale of such pawning brokering portfolio and gold investment as trading assets should be considered as trading receipts of the Appellant;

4. The Appellant being a finance company is involved in the selling of financial instruments during the course of financial services and therefore any gain on selling treasury bonds should be treated as profits from financial services during the course of its financial services which cannot be classified as a capital gain but "income and profits" within the meaning of section 3(a) of the IRA 2006.

Analysis

Abolition of Capital Gain and the effect of such abolition on the assessment

[9] The main question that requires to be decided is whether after the abolition of the capital gains tax from the tax statute, any gain or profit earned by the Appellant from the sale of pawning portfolio for Rs. 610,000,000/-, gold investment for Rs. 50,222,075/- and treasury bonds for Rs. 278,811,854/- should be treated as a capital gain not chargeable with tax or a trading profit chargeable with tax under section 3(a) of the IRA 2006.

Capital gains tax

[10] Capital gains tax is a tax on capital gain arising on the change of ownership of property and on certain type of transactions which are treated as chargeable gains other than exempted gains. Capital gain was first introduced in Sri Lanka as a source of receipt chargeable with tax by the Income Tax Act, No. 13 of 1959 by including capital gain within the definition of "profits and income" or "profits" or "income". It remained as a source of income tax continuously until the Inland Revenue (Amendment) Act, No. 10 of 2002 abolished capital gain as a source of income with effect from 31.03.2003.

[11] Prior to the abolition of the capital gains tax by the IRA 2006, the capital gain was a source of income subject to tax under section 3(h) of the Inland Revenue Act, No. 28 of 1979. Section 3 (h) reads as follows:

> *"3. For the purpose of this Act, "profits and income" or "profits" or "income" means-*
>
> *……*

(h) capital gains…"

[12] The capital gain is a profit of a capital nature which was deemed to be income for the purpose of liability to income tax under section 3(h) of the Inland Revenue Act, No. 38 of 1979 (Balaratnam, Income Tax, Wealth Tax and Gifts Tax, 1979 (p.132). In terms of the said Act, a capital gain means the profits or income, not being profits or income within the meaning of paragraphs (a), (g) or (i) of section 3 arising from-

(a) the change of ownership of any property occurring in any manner whatsoever;
(b) the surrender of some or relinquishment of any right in any property;
(c) the transfer of some of the rights in any property;
(d) the redemption of any shares, debentures or other obligations;
(e) the formation of a company;
(f) the dissolution of a business of the liquidation of a company;
(g) the amalgamation or merger of two or more businesses or companies; or
(h) any transaction in connection with the promotion of which any person who is not a party to such transaction receives a commission or reward.

[13] It is not in dispute that capital gain was not included within the meaning of "profits and income" or "profits" or "income" in the IRA 2006, which applied to the year of assessment 2010/2011 relevant to this appeal. In order to determine the legislative competence to charge income tax on any gain or profits derived from the sale of pawning portfolio, gold investment and government bonds, we have to first turn to sections 2 and 3 of the IRA 2006. In terms of section 2 of the IRA 2006, income tax shall, be charged at the appropriate rates for every year of assessment commencing on or after April 1, 2006 in respect of the profits and income of every person for that year of assessment. It reads as follows:

"2. *(1) 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, for every year of assessment commencing on or after April 1, 2006 in respect of the profits and income of every person for that year of assessment–*

(a) wherever arising, in the case of a person who is resident in Sri Lanka in that year of assessment; and

(b) arising in or derived from Sri Lanka, in the case of every other person.

(2) For the purposes of this Act, "profits and income arising in or derived from Sri Lanka" includes all profits and income derived from

services rendered in Sri Lanka or from property in Sri Lanka, or from business transacted in Sri Lanka, whether directly or through an agent".

[14] Section 3 of the IRA 2006 now 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;

(b) the profits from any employment;

(c) the net annual value of any land and improvements thereon occupied by or on behalf of the owner, in so far as it is not so occupied for the purposes of a trade, business, profession or vocation;

(d) the net annual value of any land and improvements thereon used rent-free by the occupier, if such net annual value is not taken into account in ascertaining profits and income under paragraphs (a), (b) or (c) of this section, or where the rent paid for such land and improvements is less than the net annual value, the excess of such net annual value over the rent to be deemed in each case the income of the occupier;

(e) dividends, interest or discounts;

(f) charges or annuities;

(g) rents, royalties or premiums;

(h) winnings from a lottery, betting or gambling;

(i) in the case of a non-governmental organisation, any sum received by such organisation by way of grant, donation or contribution or any other manner;

(j) income from any other source whatsoever, not including profits of a casual and non-recurring nature

[15] Therefore, the capital gains tax is not available as a source of income within the meaning of "profits and income" or "profits" or "income" in section 3 of the provisions of the IRA 2006. On that basis, the Appellant argued that the gains derived by the Appellant from the sale of the brand, portfolio, gold investment and treasury bonds are not a profit and/or income falling within the meaning of section 3(a) of the IRA 2006.

[16] Now the question is this: what is the consequence of the abolition of the capital gains tax? Does it mean that any gain or profit from a sale of a property should be automatically treated as a capital gain not chargeable with

tax, or should it depend on the nature of the gain or profit to be treated as a capital gain or a trading profit. The abolition of the capital gain, in my view does not automatically make every gain or profit made by an assessee a capital gain not chargeable with tax under the provisions of the IRA 2006.

[17] The question whether any gain or profit or receipt is in the nature of capital gain or is an adventure in the nature of an income or a trading receipt depends on the character and the circumstances of the particular transaction, and the intention of the assessee in earning a gain or a profit in the said transaction. Thus, the proceeds from the sale of an asset might be either capital or income depending on the circumstances of each case.

Trading profit and Income

[18] The definition of “trade” in section 217 of the IRA 2006 includes every trade and manufacture, and every adventure and concern in the nature of trade. The words “every adventure and concern nature of trade” make the word “trade” broad enough to cover every trade, manufacture and adventure and concern in the nature of trade.

[19] The Appellant has taken the stand before the TAC that the gain realised from the disposal of brand and gold is not a gain or income derived from the capital but a gain accruing to capital, and therefore, the brand and gold are capital assets and the disposal of such assets merely changed them into another form of asset, namely cash. In view of this stand, it is useful to understand the distinction between the “profits or income” and “capital accretion”. It has been recognised that capital accretion cannot constitute "profits or gains" within the meaning of the Income-tax Act. Rowlatt, J. in *Ryall v. Hoare and Ryall v. Honeywill*, (1923) 8 T.C. 521 at page 525, emphatically gave expression to these views: -

> *"In the first place, it is quite clear that anything in the nature of a capital accretion is outside the words 'profits or gains', as used in these Acts; that, of course, follows from the scope of the Act, and it is sanctified by the usage now of a century."*

[20] Rowlatt, J. then explains what "capital accretion" is: -

> *"That rules out, of course, the well-known case of a casual profit made upon an isolated buying and selling of some article; that is a capital accretion, and unless it is merged with other similar transactions in the carrying on of a trade, and the trade is taxed, no tax is eligible in respect of a transaction of that kind. `Profits or gains mean something which is in the nature of interest or fruit, as opposed to principal or tree."*

[21] Lord Buckmaster in *Leeming v. Jones (H. M. Inspector of Taxes)* [1930] UKHL TC15 again emphasizes at p. 357, the fact that: -

> *"… an accretion to capital does not become income merely because the original capital was invested in the hope and expectation that it would rise in value; if it does so rise, its realisation does not make it income."*

[22] Lord Viscount Dunedin at page 359, emphasized the distinction between an isolated transaction and a transaction which is in the nature of a business having quoted the well-known words of Lord Machination in the *Attorney-General v. London Country Council*4 T.C. 265 at p. 293 "that income-tax was a tax on income" and that capital accretion cannot constitute "profits or gains" within the meaning of the Income-tax Act. In *Californian Copper Syndicate (Limited and Reduced) v. Harris, decided on* (1904) 5 T.C. 159 at page 165, Lord Justice Clerk lucidly sums up a well settled principle as follows: -

> *"...Where the owner of an ordinary investment chooses to realise it, and obtains a greater price for it than he originally acquired it at, the enhanced price is not profit in the sense of Schedule D of the Income Tax Act of 1842 assessable to income-tax. But it is equally well established that enhanced values obtained from realisation or conversion of securities may be so assessable, where what is done is not merely a realisation or change of investment, but an act done in what is truly the carrying on, or carrying out, of a business."*

[23] The distinction between the capital and income was further emphasised in *Thornhill v. The Commissioner of Income Tax*, Reports of Ceylon Tax Cases Vol. 1. The main question in *Thornhill v. The Commissioner of Income Tax*, (supra) 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 (Chapter 188) 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 the realisation of capital.

[24] 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”. Soertsz, J. held however, that this statement needs qualification as all money 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:

(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.

[25] 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, 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.

Capital receipts & Revenue receipts

[26] Assets in a company can be described as anything a company owns and are listed on a company's balance sheet and assets can be categorized as either (a) real or tangible (physical assets) that draw their value from substances or properties; or (b) financial such as cash, stocks, equity instruments (e.g., share certificates), bonds, money market, funds and bank deposits; and (c) intangible which are not on physical in nature and include patents, trademarks and copyrights etc.

[27] Capital assets are any assets that are not regularly sold as part of a company's ordinary business operations but generally owned by a company to generate profit. Accordingly, examples of capital assets can be received from shareholders, debenture holders, loans from banks or financial institutions, sale of investment for getting quick money which is non-recurring in nature and usually non-routine (non-frequent in nature) and reduces the assets of the company, sale of equipment and insurance claims.

[28] The two main features of capital assets are that (a) a capital asset usually creates a liability for example, when it takes a loan from a bank; and (b) reduces the assets of the company when a company sells out its assets such as shares but creating more money in the future. (Roshan Waingankar, Capital receipts vs Revenue Receipts/Top Differences, (htpps://www.wallstreetmojo.com/capital-receipts-vs-revenue-receipts/).

[29] On the other hand, Revenue (income) in a company is what that company receives from the normal business operations from the sale of goods or services less operating expenses or sale proceeds. However, a revenue receipt does not create a liability or reduces the assets of a company and it is always a recurring in nature and earned during the normal course of business. It affects the profits or losses of a business (supra). Examples of revenue receipts include revenue earned by selling out products or services provided, discounts received from vendors, interest, rent and dividends received services, etc. (supra).

[30] The key differences between a capital receipt and a revenue receipt based on the above-mentioned sources can be summarized as follows:

1. a capital receipt is non-recurring in nature whereas a revenue receipt is recurring in nature;
2. a capital receipt either reduces the company's assets or creates liability for the company whereas a revenue receipt will not create such liability or reduces its assets;
3. a capital asset is usually fixed and non-routine whereas a revenue receipt is routine and not fixed;
4. a capital asset is derived from a non-operational source whereas a revenue receipt is derived from operational sources;
5. a capital asset will not be used to distribute profits whereas a revenue receipt will be used to distribute profits after deducting the expenses incurred to earn the revenue;
6. a capital receipt is found usually in the balance sheet of a company whereas the revenue receipt is found in the income statement of a company.

Distinction between a profit or gain in the nature of capital gain and adventure in the nature of trade- guidelines from judicial authorities

[31] The first question to be asked about any receipt is, this: is it a trading receipt or is it a capital receipt? There is, however, no infallible test for deciding whether a particular receipt is capital or trading income. Now the question is how to distinguish the profits derived by the Appellant from the sale of pawning portfolio, gold investment and government bonds and categorize them either as a capital gain or a trading profit.

[32] It is relevant to note that the character and the circumstances of the particular transaction will indicate with a definiteness that certain profits are profits of an adventure in the nature of trade or are capital accretions to an investment (Balaratnam, supra). Income Tax, Wealth Tax and Gifts Tax, 1979 (p. 132). For that purpose, all the relevant facts attaching to the transaction

must be considered and the total impression examined to come to the conclusion as to the source under which the resulting profits are assessable (Supra). The decided cases however, provide some guidelines in differentiating whether a particular profit or gain (receipt) is in the nature of a capital gain or a trading profit.

Intention

[33] One of the most important tests that laid down by the courts, where the receipt consists of the realized proceeds of an asset which has been disposed of, is the intention with which the asset was acquired. The application of this test involves a consideration of all the circumstances surrounding the acquisition of and the method with the particular asset. (Silke on South African Income 3rd Ed. P. 27). For example, if a lawyer sells of his law books, the proceeds would be of a capital nature since the books were originally acquired not for the purpose of resale at a profit but to hold as a fixed capital asset in his practice. (supra). On the other hand, the profits derived by a bookseller from the sale of books would be an income since the books were acquired for the purpose of resale at a profit (supra).

[34] This proposition can be well illustrated from the South African case of *Overseas Trust Corporation Ltd v C.I.R.* 1926 A.D. 444, where it was held that if in the course of a scheme for profit making, an asset is acquired for the purpose of resale at a profit, the proceeds derived from the sale of such asset constitute revenue derived from capital productivity employed to earn such revenue, and are of an income nature. On the other hand, if an asset is acquired to produce an income in the form of rent or dividends and not for the purpose of resale at a profit, the proceeds derived from a subsequent disposal of such asset are of a capital nature (supra). .

Change of intention

[35] On the other hand, the position may be different in regard to the question whether the receipt is of a capital nature or income nature, when there is a change of intention on the part of the assessee in regard to the use of a particular asset acquired by the assessee. Thus, where an original intention of buying such property for resale at a profit may be changed into one to hold it as an investment, and any proceeds derived from a subsequent resale of such property would be a capital nature as the owner has changed his intention from one of profit-making scheme into one of investment.

[36] On the other hand, if an original intention of acquiring property was not for resale at a profit but for investment, may be changed to one of carrying out a scheme of profit-making, and any proceeds from subsequent sale of the

property would be a trading income as the owner has changed his intention from one of investment to a profit-making scheme.

Fixed capital and floating capital

[37] The other test appears to be the fixed capital versus floating capital in that a fixed capital means property which the owner of the business wishes to keep in his own possession as a means of earning continuous profits, whereas the floating capital is property he means to turn into profits by selling at the earliest possible moment (Silke on South African Income, supra), Accordingly, receipts derived from the sale of fixed capital, where that is not the business carried on, would be receipts of a capital nature (*C.I.R. George Forest Timber Co. Ltd* (1924) A.D. 516). This proposition can be illustrated from the following examples. A delivery van is part of the fixed capital of a bakery and the proceeds resulting from the sale of the van would be capital receipts whereas the bread in the bakery is part of the floating capital and its sale to the consumer would be a trading profit (supra).

[38] In the South African case of C*.I.R. v. Niko (*1940) A.D. 416, the question was whether an amount realized for stock-in-trade when a business is sold is a receipt of a capital nature or income nature. It was held that the stock-in-trade which was acquired and owned by Niko to resell at a profit represented his floating capital and the proceeds resulting from a sale of the stock-in-trade form part of Niko's "gross income".

Isolated transactions

[39] Any frequency or isolated transaction which is not carried on in the course of business is not necessarily free from income tax but such frequency transaction not in the ordinary course of the taxpayer's business may provide a guide in determining whether a transaction is one on capital or revenue nature (Silke on South African Income, p. 32). The question whether an isolated transaction not in the course of business is in the nature of a capital or revenue depends on the profit-making intention behind the transaction (supra, p. 32).

[40] Accordingly, where a person buys a property with the intention of reselling it at a profit and any such profit made would be taxable even though such person does not ordinarily carry on any business of buying and selling property and even though the transaction may be an isolated one (supra, p. 32). The test is that if the profit arises out of trading, it is taxable notwithstanding the fact that the transaction is one of isolated one (*Stephen v. C.I.R*. (1919) W.L.D. 1). This means that the fact that a transaction is isolated is not decisive to decide whether the receipt is the capital or income and what

is decisive is whether the assessee is doing business of selling and buying property even though it carries on only one single transaction (C.I.R. v. Stott, (1928) A.D. 252).

[41] The resulting position is that the proceeds derived from a sale of property would be of an income nature under section 3 (a) if the assets were acquired for the purpose of resale at a profit-making while carrying on of a trade or business notwithstanding the fact that the transaction may be of an isolated nature (Silke on South African Income, p. 40). On the other hand, if the property is acquired for the purpose of using it for the purpose of deriving income i.e., as an investment, and not for the carrying out of a scheme for profit-making, the proceeds derived from a subsequent sale are of a capital nature (supra)

[42] On the above-mentioned principles adduced above, I shall now consider whether the sale of brand, gold investment and the treasury bonds could be considered as a capital nature not chargeable with tax under section 3 (a) of the IRA 2006. On the other hand, where the profits are made by operations of business in carrying out a scheme of profit-making, they are taxable as income under section 3 (a) of the IRA 2006.

Is the gain or profit derived from the sale of pawning business (portfolio) in the nature of capital gain or a trading profit?

[43] It would be apposite to first deal with the argument of Mr. Gunatillke that the sale of the business portfolio was a buying and selling operation during the course of the trading activities of the Appellant.

Brand and goodwill

[44] As noted, a brand including goodwill and intellectual property such as trademarks, patents or copyrights is an intangible asset which can be bought, sold and licensed. A brand therefore is vital to the success, value and growth of the appellant's business through its use in the marketplace.

[45] The question might also arise whether a goodwill associated with a brand is considered to be a capital asset. It is not in dispute that goodwill is an intangible asset of a company because it is not a physical asset that the buyer can hold onto it. When the goodwill is built by the seller, the buyer is rest assured that he can enjoy the benefits of the seller's hard work in the sense that those established supply lines and customers will continue to do business with the company despite the change in ownership. In Earl Jowitt's Dictionary of English Law, 1959 edition, "goodwill" is defined thus:

"The goodwill of a business is the benefit which arises from its having been carried on for some time in a particular house, or by a particular person or firm, or from the use of a particular trademark or trade name."

[46] The question whether a receipt derived from the sale of goodwill is taxable or not depends upon the circumstances and facts of each case. Any amount received in respect of the sale of the goodwill of a business, is a receipt of a capital nature and is not taxable provided that the seller originally purchased the business in order to derive an income from the carrying on thereof and not for the purpose of resale at a profit (Silke on South African Income Tax 93rd Ed. P 54). As long as the goodwill is a fixed amount, it partakes of the nature of capital, irrespective of whether it is one sum or in periodic instalments (Ibid)

[47] However, where it is clear from the terms of an agreement that a payment is not received for the sale of goodwill but merely for the right of use thereof for a certain period on the expiration of which the goodwill is to revert to the owner, then such payment is in the nature of income (I.T.C. No. 66, 2 S.A.T.C. 259). Court decisions have suggested that goodwill can be classified as a capital asset. In *Inland Revenue Commissioners v. Muller & Co's. Margarin*, Ltd. (3), Lord Macnaghten at pp. 223 and 224 made the following observations:

"What is goodwill? It is a thing very easy to describe, very difficult to define. It is the benefit and advantage of the good name, reputation, and connection of a business. It is the attractive force which brings in custom. It is the one thing which distinguishes an old established business from a new business at its first start..... if there is one attribute common to all cases of goodwill it is the attribute of locality. For goodwill has no independent existence. It cannot subsist by itself. It must be attached to a business. Destroy the business, and the goodwill perishes with it, though elements remain which may perhaps be gathered up and be revived again."

[48] In the Australian case of *Daniell v. Federal Commissioner of Taxation*, where Knox, C. J., observed:

"My opinion is that while it cannot be said to be absolutely and necessarily inseparable from the premises or to have no separate value, prima facie at any rate it may be treated as attached to the premises and whatever its value may be, should be treated as an enhancement of the value of the premises."

[49] In the second Australian case reported in *Federal Commissioner of Taxation v. Williamson* Rich, J., observed at page 564 as follows:

"Hence to determine the nature of the goodwill in any given case, it is necessary to consider the type of business and the type of customer which such a business is inherently likely to attract as well as the surrounding circumstances.... The goodwill of a business is a composite thing referable in part to its locality, in part to the way in which it is conducted and the personality of those who conduct it, and in part to the likelihood of competition, many customers being no doubt actuated by mixed motives in conferring their custom."

[50] In *M/SS.C. Cambatta and Co. Private Ltd. vs. Commissioner of Excess Profits Tax, Bombay,*961 AIR 1010, the Indian Supreme Court stated:

"It will thus be seen that the goodwill of a business depends upon a variety of circumstances or a combination of them. The location, the service, the standing of the business, the honesty of those who run it, and the lack of competition and many other factors go individually it, and the lack of competition and many other factors go individually or together to make up the goodwill, though locality always plays a considerable part. Shift the locality, and the goodwill may be lost. At the same time, locality is not everything. The power to attract custom depends on one or more of the other factors as well. In the case of a theatre or restaurant, what is catered, how the service is run and what the competition is, contribute also to the goodwill" (paragraph 15).

[51] It is not in dispute that the Appellant as a finance company was, *inter alia,* carrying on the business of a pawnbroker and lending money on the pledge of the article. It is not in dispute that the pawning business was the intangible asset of the appellant and the appellant carried on the pawning business using the brand "LOLC Ransavi" and using the initial equity via investments as integral part of its business operations. The said brand is associated with its business and goodwill for future economic benefit and long-lasting value and therefore, it is a capital asset of the Appellant.

[52] There is no material whatsoever, to show that the original intention of the appellant to acquire the pawning business using initial equity via investments was changed, or that the original intention from one of investment was changed to a profit-making scheme by reselling it at a profit in the course of trade or business so as to make it profit-making business.

[53] On the scrutiny of the facts of the case, including the case flow statement, it is revealed that during the year of assessment, the appellant had sold its total pawning portfolio and goodwill to the value of Rs. 1,790,641,246/- and that the profit made from the sale of pawning portfolio and goodwill was Rs. 610,000,000/- (p. 24 of the TAC brief). It had been calculated in the following manner:

Description	Carrying amount in Financial Statement (Rs)	Selling Price	Profit on Sale
Pawning Portfolio-Value of pawning advances granted	1,180,641,246	1,180,641,246	
Sale of Pawning Brand		400,000,000	400,000,000
Realization of Goodwill		210,000,000	210,000,000
Total	1,180,641,246	1,790,641,246	610,000,000

[54] It is manifest that the table indicates the profits made from the sale of pawning brand and goodwill and not the sale of pawning portfolios (p. 24 of the TAC brief). The Appellant has taken up the position before the TAC that after the Company transferred its pawning portfolio to LOLC Micro Credit Ltd, it discontinued its pawning operations and the pawning business was carried out by LOLC Micro Credit Ltd.

[55] The commissioner in the determination of the appeal (p. 100 of the TAC brief) in rejecting the profit on sale of the pawning portfolio as a capital gain states that both the Appellant and LOLC Micro Credit Ltd. are subsidiary companies and that the Appellant has not produced any evidence for recognition and reorganization of the brand Ransavi.

[56] A perusal of the document marked “B1” at page 159 of the TAC brief pertaining to LOLC Micro Credit Ltd dated 09.01.2017 however, reveals that the Appellant had transferred its intangible asset of the brand name LOLC Ransavi” to LOLC Micro Credit Ltd and produced documentary evidence to the Commissioner to support the sale and acquisition of the pawning business (LOLC Ransavi”) from LOLC Finance PLC. The commissioner’s determination in respect of LOLC Micro Credit Ltd at p. 157 of the TAC brief as follows:

> *“The reason for disallowing the capital allowance on the intangible asset of the brand name of LOLC Ransavi” was fishiness of the transaction n occurred between the related parties and the non-submission of the documentary evidence to substantiate it. During the stage of appeal gearing documentary evidence was produced to support the acquisition of the brand name. So, this fact was not contested by the representative of the Inland Revenue Department (IRD).*
>
> *The contention of the representative of the IRD was that the capital allowance or rather the transaction of the amortization of the intangible*

asset of the brand name cannot be allowed for deduction as the transaction has taken place between related parties. I am of the view that this contention is untenable and does not hold any validity or credibility as there is no provision in the Act prohibiting the transaction between two related parties…".

[57] It is manifest that the Appellant had sold its intangible capital asset of the pawning portfolio (brand and goodwill) to LOLC Micro Credit Ltd in relation to the assessment made against LOLC Micro Credit Ltd. On a perusal of the statement of accounts or the documents filed on record reveals that the Appellant being involved in the business of pawn brokering had made an investment and sold the entire pawning business to LOLC Micro Credit Ltd.

[58] A perusal of the statement of accounts further reveals that the disposal of the brand and goodwill had been done by the company as an isolated transaction not in the course of the Appellant's ordinary business of profit-making scheme. The intention and motive behind the transaction do not appear to be one of the profit-making such as buying and selling the pawning portfolio. In the present case, the statement of accounts or documentary evidence in the present case, however, does not support a conclusion that the object of the transaction was to buy and sell the intangible brand and goodwill of the Appellant.

[59] In the circumstances, the TAC was wrong, without identifying the character and the circumstances of the transaction in holding that after the abolition of the capital gain, any gain or profit received by the appellant for the sale of brand should be considered as income falling under section 3(a) of the IRA 2006.

Is the gain or profit derived from the sale of gold investment in the nature of capital gain or a trading profit?

[60] The question whether such gain derived from the sale of pawning business is taxable or not also depends upon the nature and character of the transaction. The answer to this question will decide whether the profit it made from the sale constitutes an ordinary trading income or capital gain.

[61] The assessor has categorized the sale of gold investment in a sum of Rs. 50,222,075/- as a profit on the basis that the Appellant had failed to explain under which section of the IRA 2006, the Appellant claimed the exemption of gain derived from the sale of gold investment. The CGIR has taken the view that as the Appellant was engaged in the finance business which deals with pawning and trading etc., the particular gain or profit could be treated as "profits and income" earned in the business of a finance company and hence, the Appellant is liable for income tax. The CGIR has, however, not referred to

any document to substantiate his finding except to refer to the words “profits on sale” in the statement of accounts of the Appellant.

[62] It is true that the sale of the pawned article is occasioned by the action of the Pawn-broker where the pawner defaults the payment and discharges of loan or redemption (K*arnataka Pawn Brokers Assn. and Others v State of Karnataka and Others* (S.C. decided on 29.10.1998). p/ 18). The pawner who pledges the article with the licensed pawnbroker, not only parts with the possession of the pledged article in favour of the pawn-broker, but by virtue of such pledge parts with the rights he held to sell the pledged article in case of default of payment and discharge of loan or redemption of the article pledged within the time stipulated by the contract or by the provisions of the Pawn Brokering Act. (*Kandula Radhakrishna Rao and Others v The Province of Madras*, 2 STC 121).

[63] The question of sale of gold arises by the default of the pawner in redeeming the pawned articles and therefore, it is incorrect to state that they are engaged in the business of buying and selling property contrary to the contract or other statutory provisions (e.g., the Pawn Brokering Act (K*arnataka Pawn Brokers Assn. and Others v State of Karnataka and Others* (S.C. decided on 29.10.1998). p/ 18).

[64] It is not in dispute that the Appellant who acquired gold stocks for the purpose of holding them as an investment and carrying on pawning business with the intention of capital appreciation in the course of its pawning business. The enhanced value of the gold stocks of the Appellant can be regarded as fixed capital assets. The Appellant held its gold stocks for the purpose of pawning business for some time as an investment and disposed of them during the year of assessment for Rs. 50,222,075/-.

[65] The gold investment made by the Appellant in gold stocks for its pawning business does not constitute its stock-in-trade but represents fixed assets and the profit derived from the realization of the sale of gold stocks thus, attracts capital gain, irrespective of whether it is a short-term capital gain. It would not, in my view, attract income tax as “profits and income” or “profit” or “income” under section 3(a) of the IRA 2006.

Is the gain or profit derived from the Treasury Bonds in the nature of capital gain or a trading profit?

[66] The Appellant’s contention is that the Appellant invested in treasury bonds, which are held by the company for the purpose of earning interest income and the gain arising from the sale of treasury bonds was a non-recurring transaction. The Appellant submitted that it invested its excess funds in the treasury bonds with a view to earn interest income over a period of

time. It had further claimed that the interest earned during the period of holding the investment was calculated based on the coupon rate indicated in the instrument and the relevant income tax on the interest income was duly paid by the Appellant (TAC brief, p. 161). On that basis, the Appellant argued that there was no intention on the part of the Appellant to make profits arising out of the treasury bonds gain of Rs. 278,811,854/-, which is a capital gain that attracts no tax under section 3 (a) of the IRA 2006.

[67] The Appellant relied on the decision of the Court of Appeal in *John Keels Holdings PLC v CGIR* CA Tax 8/2010 decided on 28.06.2010 in support of its contention that the profits of the sale of treasury bills and bonds are capital gain and not liable to income tax under section 3(a)of the IRA 2006. A perusal of the said judgment, however, reveals that the said case dealt with the provisions of section 14(1) (a) (xxii) of the Inland Revenue Act, No. 29 of 1979 as amended by the Inland Revenue (Amended) Act, No. 35 of 1993. It seems that the relevant year of assessment in that case was 1994/1995. Section 14(1)(xxii) of the Inland Revenue (Amendment) Act, No. 35 of 1993 provided that the capital gain arising out of the sale of treasury bills in the secondary market is exempt from income tax. It reads as follows:

> *"There shall be exempt from income tax any capital gain arising on the sale by any person of any treasury bill held by such person in the secondary market".*

[68] Under such circumstances, the Court of Appeal held in that case that the sale of treasury bills in the secondary market was exempted from tax. The capital gain is not available under the provisions of the IRA 2006. Therefore, the judgment in *John Keels Holdings PLC v CGIR* (supra) will not apply to this case, which relates to the year of assessment 2010/2011 under the provisions of the IRA 2006.

[69] The learned President's Counsel for the Appellant argued that the gain derived from the sale of treasury bonds attracts a capital gain because the Appellant is not involved in buying and selling business and therefore, it is not taxable. The learned Additional Solicitor-General, however, argued that the sale of treasury bonds took place during the course of the finance business of the Appellant and therefore, it attracts a trading profit. In order to deal with these submissions, it is necessary for us to consider the following points:

(1) Whether the transaction of sale of treasury bonds was a part of the buying and selling business which the company carried on or was it an essential or normal step in conducting its business;

(2) Whether the transactions actually carried on by the company were merely a realization or change of investment or enhancing its investment rather than an act of carrying on, or carrying out, of a business.

(3) If not, whether the profits arising from the sale of treasury bonds should be classified as revenue receipts or trading profit chargeable with income tax.

[70] It is not in dispute that treasury bonds are purchased from the secondary market by investing with a view to earn an interest income and the Appellant had received interest income on the treasury bonds during the relevant period and the same is listed in the Income Statement (p. 73 of the TAC brief).

[71] There is no dispute that the Appellant invested its excess funds in the treasury bonds, acquired the same with the intention of earning an interest income and paid interest on the interest income. Treasury bonds are clearly listed in the balance sheet of the Appellant's statement of accounts and therefore, treasury bonds are capital assets of the Appellant.

[72] The available material reveals that the treasury bonds were acquired and held by the Appellant with the intention of earning an interest income and out of them, the Appellant sold treasury bonds in a sum of Rs. 278,811,854/- to further obtain or enhance a greater price for them than he originally acquired it at the beginning. As noted, in *Californian Copper Syndicate v. Harris* (1904) 5 Tax Cas. 159, 165-166, Lord Justice Clerk observed that:

> *"It is quite a well-settled principle in dealing with questions of assessment of income tax, that where the owner of an ordinary investment chooses to realise it, and obtains a greater price for it than he originally acquired it at, the enhanced price is not profit in the sense of Schedule D of the Income Tax Act, 1842, assessable to income tax. But it is equally well established that enhanced values obtained from realisation or conversion of securities may be so assessable, where what is done is not merely a realisation or change of investment, but an act done in what is truly the carrying on, or carrying out, of a business. The simplest case is that of a person or association of persons buying and selling lands or securities speculatively, in order to make gain, dealing in such investments as a business, and thereby seeking to make profits. There are many companies which in their very inception are formed for such a purpose, and in these cases it is not doubtful that, where they make a gain by a realisation, the gain they make is liable to be assessed for income tax.*
>
> *What is the line which separates the two classes of cases may be difficult to define, and each case must be considered according to its facts; the question to be determined being--Is the sum of gain that has been made a mere enhancement of value by realising a security, or is it*

a gain made in an operation of business in carrying out a scheme for profit-making? "

[73] Again, the Indian case of *Sardar Indra Singh & Sons Ltd. v. Commissioner of Income Tax, [1953] 24ITR415(SC)* appears to be a guiding principle for deciding the instant case. The head-note runs as follows:

> *" Profits realised on a change of investment simpliciter are not taxable. But if the change of investment was necessary and was in fact made for the purpose of and was an act done in normally carrying on the business of the company, then what is done is not merely a realisation or change of investment but an act done in what is truly the carrying on, or carrying out, of a business.*
>
> *Before it can be held that a profit arises from a transaction which forms part of a company's business it must be shown that the company was not only entitled to enter into that transaction under its memorandum of association but the transaction was part of the business which it carried on or was an essential or normal step in conducting its business. The objects stated in the memorandum of association are not conclusive. Essential features of the business actually carried on by the company must be regarded and distinguished from what may be called incidental acts of administration. "*

[74] In the present case, there is no material whatsoever, to find that the Appellant company was formed for the purpose, of acquiring and reselling securities for profit-making or having acquired and held securities, it changed in original intention from earning interest income to one to buying and selling treasury bonds for profit-making, and that the Appellant's transaction was an essential part of the business of buying and selling treasury bonds. In the result, it cannot be held that the gain derived from the sale was a regular transaction which was part of the business carried on, or it was an essential or normal step in conducting its business of buying and selling of the Appellant.

[75] For those reasons, I hold that the gain derived by the Appellant from the sale of treasury bonds, would not attract income tax as "profits and income" or "profit" or "income" under section 3(a) of the IRA 2006.

[76] For those reasons, I hold that the TAC erred in holding that the gain received by the Appellant from the sale of the pawning business (brand and goodwill), gold investment and the treasury bonds should be considered as income falling under section 3(a) of the IRA 2006.

Conclusion

[77] For those reasons, I answer the questions of law in favour of the Appellant and against the Respondent as follows:

1. The abolition of the capital gain does not automatically make any gain or profit made by an assessee a capital gain not chargeable with tax under the provisions of the IRA 2006. The question whether a gain or profit derived from the sale of the pawning business (brand and goodwill), gold investment and the treasury bonds is in the nature of a capital gain not chargeable with income tax or in the nature of income or profit falling under section 3(a) of the IRA 2006 depends on the character and the circumstances of the particular transaction. The TAC erred in holding that merely because of the concept of the capital gain is not available under the IRA 2006, every gain received by the Appellant from the sale of the pawning business (brand and goodwill), gold investment and treasury bonds should be considered as income falling under section 3(a) of the IRA 2006.

2. The TAC erred in holding that merely because of the concept of the capital gain is not available under the IRA 2006, every gain received by the Appellant from the sale of the pawning business (brand and goodwill), gold investment and treasury bonds should be considered as income falling under section 3(a) of the IRA 2006.

3. Yes

4. Yes

5. Yes

6. Yes

7. The TAC erred in law in determining that the gain of Rs. 278,811,854/- which has been derived by the Appellant from the disposal of its investment in treasury bonds is income under section 3(a) of the Inland Revenue Act, No. 10 of 2006.

[78] In the circumstance, I annul the determination made by the Tax Appeals Commission dated 21.05.2019 and the Registrar is directed to send a 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