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/048/2017 by the Tax Appeals Commission under Section 11A of the Tax Appeals Commission Act No. 23 of 2011 (as amended).

CA Case No: CA/TAX/23/2024
Tax Appeals Commission No.
TAC/IT/048/2017

Lexinton Holdings (Pvt) Ltd,
No. 10, Gothami Road,
Colombo 08.

Appellant

Vs.

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

Respondent

Before: **M.C.B.S. Morais J.**
&
Annalingam Premashanker J.

Counsel: F.N. Goonewardena with Aparna Kulathunga for the Appellant.

Shehan Soysa, SSC for the Respondent.

Written Submissions: By the Appellant – on 08.07.2026, 25.07.2024

By the Respondent – on 09.06.2026, 21.05.2025

Argued on: 29.04.2026

Decided On: **03.09.2026**

JUDGMENT

M.C.B.S. Morais J.

This is an appeal by way of case stated against the determination of the Tax Appeals Commission (TAC) dated 11th of October 2023, in the case of TAC/IT/048/2017.

This appeal is filed under Section 11A(1) of the Tax Appeals Commission Act No. 23 of 2011 (as amended).

The tax in dispute is against the assessment made for the taxable period 2011/2012 and the taxable amount in dispute is Rs. 50,656,995.00 with a penalty of Rs. 25,328,497.00.

FACTUAL BACKGROUND

The Lexinton Holdings (Pvt) Limited (hereinafter will be referred to as the Appellant) is a limited liability company incorporated and domiciled in Sri Lanka. The principle activity of the Appellant is maintaining commercial property, dwelling flats for lease.

The Appellant has submitted the return for the taxable period 2011/2012. The Assessor rejected the said return by disallowing the claim made by the Appellant in intimation letter dated 27th of November 2014. Accordingly, the Assessor has issued the Notice of Assessment dated 28th of November 2014 based on the reasons set out in the intimation letter.

The Appellant being aggrieved by the decision of the Assessor, made an appeal to the Commissioner General of Inland Revenue (hereinafter will be referred to as the Respondent). The Respondent in his determination dated 11th of January 2017 determined the appeal by confirming the assessment issued by the Assessor. The Appellant being dissatisfied with the said determination of the Respondent, made an appeal to the Tax Appeals Commission (TAC) on the basis that the assessment issued by the Senior Deputy Commissioner of the Department of Inland Revenue is time barred. The TAC after considering the submissions made by both parties made the determination dated 11th of October 2023 in favor of the Respondent.

Being dissatisfied with the said determination, the Appellant has requested the TAC to cause a Case Stated to the Court of Appeal on the following Questions of Law.

I. *"Has the Tax Appeals commission erred in determining that the Notice of Assessment is not time barred?*

II. *Has the Tax Appeals Commission erred in implicitly determining that the interest income of the Appellant comes within Clause 3(e) of the Inland Revenue Act No: 10 of 2006 (as amended) and therefore, the Appellant is not entailed to deduct any interest cost incurred in deriving the said income under Section 25(1) (f) of the Inland Revenues Act No: 10 of 2006 (as amended)?*

III. *Has the Tax Appeals Commission erred in concluding that the deduction under section 25(1) (f) of the Inland Revenues Act No:10 of 2006 (as amended) cannot be made since the Appellant has borrowed at a higher rate of interest at a lower rate, a criteria which is irrelevant to section 3 of the IRA?*

IV. *Has the Tax Appeals Commission erred in determining that the Appellant's interest income cannot be treated as business income as the Appellant has not registered or paid Economic Service Charge?*

V. *Has the Tax Appeals Commission used the registration for Value Added Tax on Financial Services ('FS VAT) as a criteria to deny the Appellant its entitlement to claim a deduction under section 25(1) (f) of the IRA despite the Appellant having registered and paid FS VAT from the year of assessment 2014/2015 (after the VAT registration threshold was triggered)?*

VI. *Without prejudice to (2) above and in the alternative to (2) above, has the Tax Appeals Commission erred in its Determination by deciding that the Appellant is not entitled to a deduction under Section 32 of the Inland Revenue Act No10 of 2006 (as amended)?"*

According to the Appellant's written submission dated 8th of July 2026, it is informed to this court that the first question of law in relation to the time bar on the assessment is not pursued. Therefore, rest of the questions shall be addressed in this Judgment.

The substantive issue in relation to the current appeal revolves around the eligibility of the Appellant in relation to certain deductions under section 25(1) of the Inland Revenue Act No. 10 of 2006 (as amended) ('IRA 2006'). The Questions of Law No. II, III, IV, and V together address the substantive matter of the case. Therefore, I shall consider the Questions of Law No. II, III, IV, and V together in the following manner.

ANALYSIS

The Appellant is engaged in the business of lending money and receives an interest from the borrowers. Accordingly, it is the contention of the Appellant that the interest income received by the Appellant falls under the profits from any trade or business carried on/ exercised by the Appellant under section 3(a) of the IRA 2006. On this basis, the Appellant argues that it is entitled for the deduction of interest expense under section 25(1) of the IRA 2006.

On the other hand, the Respondent argues that the profits received by way of interest income shall be fallen under section 3(e) of the IRA 2006 which identifies the interest income separately. Hence, the Respondent has disallowed the interest expense in terms of section 25(4) of the IRA 2006.

The Appellant is engaged in the business of lending money, which constitutes a substantial part of its business activities, and derives income by way of interest from such lending. In this context, the interest income received by the Appellant can be regarded as income arising from its business activity. However, whether such income falls within section 3(a) or section 3(e) of the IRA 2006 is not, in my view, determinative of the issue presently under consideration. The principal question before this court is whether the interest paid or payable by the Appellant is deductible under section 25(1)(f) of the IRA 2006.

Section 3 of the IRA 2006 sets out the categories of taxable profits or income. Chapter IV, on the other hand, deals with the ascertainment of profits or income, and section 25 specifically deals with deductions allowed in ascertaining profits and income. Section 25(1) provides that, subject to the provisions of subsections (2) and (4), all outgoings and expenses incurred in the production of profits or income from any source shall be deducted. Section 25(1)(f) expressly includes "interest paid or payable by such person" in the following manner;

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

Section 25(1) provides that, when calculating a person's taxable profits or income from any source, expenses incurred in producing that income may be deducted, subject to the limitations in sections 25(2) and 25(4). Section 25(1)(f) specifically allows the deduction of interest paid or payable by the taxpayer. In simple terms, where a person incurs an interest expense in order to earn income, that interest expense can generally be deducted when calculating the taxable profit from that source.

It is significant that section 25(1) does not restrict the deductions provided therein to income falling under any particular paragraph of section 3. The provision refers broadly to the ascertainment of "profits or income of any person from any source". Accordingly, once the income is taxable under section 3 and it becomes necessary to ascertain the profits or income from that source, the provisions of section 25 become relevant, subject to the specific limitations contained in the Act.

Having considered the facts and circumstances of the case, it is apparent that the Appellant has obtained funds from its investors and utilised those funds in carrying on its lending business. The interest paid or payable to the investors is therefore an expenditure incurred in connection with the Appellant's income producing activities. It constitutes a cost incurred in obtaining and utilising the funds employed in the business and therefore bears a direct connection with the production of the Appellant's income.

Further, the interest expenditure in question does not appear to fall within any of the deductions expressly disallowed under section 26 of the IRA 2006, which deals with deductions not allowed in ascertaining profits and income. In the absence of any specific provision rendering the expenditure non-deductible, and having regard to the express wording of section 25(1)(f), the interest paid or payable by the Appellant can be deducted in determining its profits or income.

This position is also supported by the decision in ***ICCI Bank Ltd V. Commissioner General of Inland Revenue*** (Income Tax Stated Case) [2015] 1 SRI-LR 140, His Lordship Justice L. T. B. Dehideniya J. observed that the provision relating to the deductions under section 25(1) must be read together with section 26(1) of the IRA 2006. Accordingly, the question whether an expense is deductible should be considered having regard not only to the general deduction allowed under section 25(1), but also to whether the particular expense is one which is expressly excluded from deduction under section 26(1).

> *"The Section 25(1)(f) provides that when ascertaining profit or income of any person from any source, all outgoings and expenses incurred by such person, in the productions thereof, including interest paid or payable by such person to be deducted. Under this Section, the meaning of the phrase ·all outgoings and expenses incurred by such person in the production thereof must be considered. My view is that it means the outgoings and expenses incurred for the purpose of generating the taxable Income, and it is the one that can be deducted. The word ·thereof referred to the income generated by expending the said outgoings and the expenses. This concept is more clearly explained in Section 26(1)(g). It says ·for the purpose of ascertaining the profits or income of any person from any source, no deduction shall be allowed in respect of-any disbursements or expenses of such person, not being money expended for the purpose of producing such profits or income·. These two Sections have to be read together. It has been held in the Rodrigo case that any disbursement or expense which was not spent for the purpose of production of profits and income cannot be deducted and all outgoing expenses incurred by a person in the production of income could be included as deductions. Court further held that if any part of the expenses could be clearly identified as having been expended for the purpose of deriving money not being profits or income liable to tax such amount could not be deducted in terms of Section 26(1)(g)"*

In my view, it is therefore unnecessary to determine whether the Appellant's interest income falls strictly within section 3(a) or section 3(e) for the purpose of determining its entitlement to this deduction. Once the income is taxable under section 3, the question of the expenses allowable in ascertaining that income falls to be determined under section 25 and 26. On the facts of this case, the interest expenditure was incurred in financing the Appellant's lending business and falls within the express wording of section 25(1)(f). The Appellant is therefore entitled to claim the deduction in respect of such expenditure from the interest income.

It may have been different if the Appellant has invested his own money and earned an interest income. However, in this matter it is undisputed that the Appellant is an investment company and reinvests the money invested by the investors. Hence, the Appellant has to pay an interest to its investors, which should come out of the interest earned by the Appellant. If a different interpretation is given, the provisions of Section 25(1)(f) would become meaningless.

I am therefore of the view that the interest paid or payable by the Appellant is deductible in ascertaining its profits or income, notwithstanding the manner in which the income itself is categorised under section 3 of IRA 2006.

Moreover, the TAC has erred in its determination by categorizing the business income of the Appellant under section 3 of the IRA 2006, and failing to allow the deductions available under section 25(1)(f) of the IRA 2006.

Hence, I answer the Questions of law No. II, III, IV, and V in the affirmative.

Since the substantive issue in relation to this case is decided in the foregoing manner, the Question of law No.VI shall not arise.

CONCLUSION

When considering the facts and the circumstances of the case, in line with the materials presented before this court, I am of the considered view that the questions of law formulated by the Appellant should be answered as set out below.

Question of law I – Not Pursued

Question of law II – Affirmative

Question of law III – Affirmative

Question of law IV – Affirmative

Question of law V – Affirmative

Question of law VI – Need not be addressed

This appeal is allowed.

The determination of the TAC dated 11th of October 2023, and the determination of the Respondent dated 11th of January 2017 is overruled and the assessment dated 28th of November 2014 issued by the Deputy Commissioner of Inland Revenue is null and void.

The Registrar is directed to issue a copy of this judgment to the Secretary of the Tax Appeals Commission for necessary actions.

Judge of the Court of Appeal

Annalingam Premashanker J.

I agree

Judge of the Court of Appeal