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

In the matter of an Appeal under section 170 of the Inland Revenue Act No. 10 of 2006 (as amended) from a determination of the Tax Appeals Commission.

CA Case No: CA/TAX/58/2023

Tax Appeals Commission No.

TAC/IT/112/2018

Cargills Bank Ltd,
696, Galle Road,
Colombo 03.

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:	Avindra Rodrigo, PC with Akiel Deen instructed by M.J.S. Fonseka for the Appellant. Sehan Zoysa, SSC for the Respondent.
Written Submissions:	By the Appellant – on 11.03.2026, 15.07.2024 By the Respondent – on 05.03.2026, 09.08.2024
Argued on:	14.01.2026
Decided On:	**11.06.2026**

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 30th of March 2023, in the case of TAC/IT/112/2018.

This appeal is filed under section 170 of the Inland Revenue Act No. 10 of 2006 (hereinafter will be referred to as 'IRA 2006').

The tax in dispute is against the assessment for the year of assessment 2013/2014 and the taxable amount in issue is Rs. 81,707,405.00 with a penalty of Rs. 40,853,702.00.

FACTUAL BACKGROUND

The Cargills Bank Ltd (hereinafter will be referred to as the Appellant) is a public limited liability company incorporated and domiciled in Sri Lanka. The principal activities of the

Appellant include carrying on banking business and off-shore banking business. The Appellant has furnished the income tax for the year of assessment 2013/2014, for the period from 1st of April 2013 to 31st of March 2014, which was rejected by Deputy Commissioner of the Department of Inland Revenue by the Intimation letter dated 17th of May 2016 and a new assessment was issued. Being dissatisfied with the assessment issued, the Appellant has lodged an appeal to the Commissioner General of Inland Revenue (hereinafter will be referred to as the Respondent), having heard the appeal, the Respondent has confirmed the assessment issued by the Deputy Commissioner of the Department of Inland Revenue in the determination dated 28th of May 2018.

Being aggrieved by the said determination, the Appellant has made an appeal dated 18th of September 2018 to the TAC. The TAC after hearing the submissions made by both parties, have confirmed the determination of the Respondent for the reasons set out in the determination dated 30th of March 2023. 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. *"When an Assessment is issued assessing the income of the Company under section 3(a) being a profit from any trade, business, profession or vocation, can the CGIR to take up the position at the appeal hearing stages, that issuing the Assessment under section 3(a) is not correct and the Assessment should have been made under section 3(e) to disallow the expenditure incurred in the production of income?*

II. *When an Assessment is issued assessing income of the Company under section 3(a) can the CGIR take upon the position that the Taxpayer has not commenced business?*

III. *Can the CGIR take up the position that an Assessment should have been raised under section 3(e) of the Inland Revenue Act in defense of an Assessment raised against the Taxpayer assessing income tax under basis of section 3(a) of the Inland Revenue Act?*

IV. *Is the Appellant allowed to deduct the interest expenditure as an allowable or claimable expense when such interest expenditure was incurred in respect of funds which were used to generate income assessable for income tax?*

V. *Does a general administration and management expense incurred by the Company in preparation of production of income during the period where a provisional banking license was issued to the Appellant constitute outgoings and expenses incurred in the banking business?"*

ANALYSIS

The Deputy Commissioner has disallowed the Appellant's claim for interest, personal expenses, and other expenditure on the ground that the Appellant has failed to furnish the documents and particulars requested in support of such deductions. In addition, the Deputy Commissioner has rejected the Appellant's claim for capital allowances on the basis that the relevant assets were not in use during the year of assessment in question.

It is the Respondent's position that, according to the letter issued by the Director of Bank Supervision of the Central Bank dated 6th of September 2011, the provisional approval to establish a bank was given subject to specified terms and conditions, including that the Appellant's core business should be in the 'SME sector, farmers, and low- and middle-income groups, while also diversifying into corporate banking services'. On this basis, the Respondent asserts that the Appellant has commenced its banking operations only with effect from 21st January 2014. Accordingly, the Respondent contends that, during the year of assessment 2013/2014, the Appellant was not engaged in any banking business.

Respondent further contends that, as no commercial operations were carried out during the relevant period, the investment income of the Appellant cannot be treated as profits and income arising from a business within the meaning of section 3(a) of the Inland Revenue Act, No. 10 of

2006. Consequently, the Respondent has classified such investment income as falling under section 3(e) of the said Act.

However, it is the contention of the Appellant that the Respondent is not authorized by law to change the basis of the assessment by assessing the income under section 3(e) after the Deputy Commissioner has made the assessment of the income under section 3(a) of IRA 2006 under 'profits from Trade or Business'.

On this basis The Appellant has raised five questions of law, and I shall address them in the following manner.

Questions of Law I and III

I . When an Assessment is issued assessing the income of the Company under section 3(a) being a profit from any trade, business, profession or vocation, can the CGIR to take up the position at the appeal hearing stages, that issuing the Assessment under section 3(a) is not correct and the Assessment should have been made under section 3(e) to disallow the expenditure incurred in the production of income?

III. Can the CGIR take up the position that an Assessment should have been raised under section 3(e) of the Inland Revenue Act in defense of an Assessment raised against the Taxpayer assessing income tax under basis of section 3(a) of the Inland Revenue Act?

Since the questions of law I and III are similar in nature, referring to the power of the Respondent to revise an assessment, I shall deal with these two questions of law together.

The Appellant has furnished the income tax for the year of assessment 2013/2014 which was rejected by Deputy Commissioner of the Department of Inland Revenue by the Intimation letter dated 17th of May 2016 and a new assessment was issued. The Deputy Commissioner of the Department of Inland Revenue has rejected Appellant's return for the following reasons;

1. The interest, Personnel and other expenses of the Appellant cannot be allowed as expenses incurred for the purpose of ascertaining the profit or income under section 25(1) of IRA 2006.

2. The Appellant is not entitled to claim the capital allowances on the assets in ascertaining the profits for the income tax purposes under section 25(1) of IRA 2006, since the Appellant has not used these assets during the said year of assessment.

Being dissatisfied with the assessment issued, the Appellant has lodged an appeal to the Respondent. The Respondent after hearing both the parties have affirmed the assessment of the Deputy Commissioner of the Department of Inland Revenue and concluded in the following manner, which is mentioned in the reasons given for the Respondent's determination dated 10th of August 2018.;

> *"Income derived from investing shareholders' funds and investments in treasury bills and fixed deposits to be treated as other income and to be taxed under section 3(e) of Inland Revenue Act No 10 of 2006, since company has not commenced commercial operations to treat as profits from any trade, business, profession or vocation per the 3(a) of the Act.*
>
> *Based on the above, the submission given by the representative of the appellant company in this regard cannot be accepted."*

It is the contention of the Appellant that the Respondent is not empowered by law to change the basis of the assessment in the appeal stage. On this basis the Appellant contends that, under section 165 (13) of the IRA 2006, the Respondent is not allowed to change the basis of an assessment which was issued by the Deputy Commissioner of the Department of Inland Revenue.

The section 165 (13) of the IRA 2006, which deals with the Appeals to the Commissioner-General, mentions the powers vested on the Commissioner General in terms of the appeals against the assessment issued.

> *"(13) In determining an appeal under this section, the* ***Commissioner General may confirm, reduce, increase or annul the assessment appealed against*** *and shall give notice in writing to the appellant, of his determination on the appeal."*

According to section 165(13) of IRA 2006, the Respondent is empowered by law only to confirm, reduce, increase or annul the assessment against which the appeal was tendered. Further, the provision does not provide for the Respondent to amend the assessment already issued by the Deputy Commissioner of the Department of Inland Revenue. The only resort the Respondent has in terms of changing the basis of the assessment which was already issued is by an annulment. However, the Respondent has acted beyond his power by revising the basis of the assessment which was already issued.

By altering the basis of the original assessment, the Respondent has in effect annulled that assessment. While the Respondent is empowered to annul the said assessment, he has no authority at the appeal stage to substitute it with a fresh assessment.

Therefore, it is my view that the Respondent is not empowered by law to revise the basis of an assessment, which was already issued by the Deputy Commissioner of the Department of Inland Revenue in the appeal hearing stage.

Hence, I answer the question of law I and III in the Negative.

Questions of Law II and IV

II. When an Assessment is issued assessing income of the Company under section 3(a) can the CGIR take upon the position that the Taxpayer has not commenced business?

IV. Is the Appellant allowed to deduct the interest expenditure as an allowable or claimable expense when such interest expenditure was incurred in respect of funds which were used to generate income assessable for income tax?

Since the questions of law II and IV are similar in nature, referring to the commercial operation of the Appellant, I shall deal with these two questions of law together.

According to question of law II, it is the contention of the Appellant that the income received during the above taxable period, was after the commencement of the business operations of the Appellant, and the profit need be treated as profits from any trade, business, profession or vocation as per section 3(a) of IRA 2006.

It is the position of the Appellant that they have commenced banking business from 21st of January 2014. This position have never been challenged but confirmed by the Respondent. Therefore, the period from 21st of January 2014 to 31st March 2014 invariably falls within the relevant tax year.

The TAC in upholding the determination of the Respondent has held as follows;

> *"Information in these documents have further revealed that the Company has started banking business from 21st January 2014 and was not involved in banking business from 01.01.2013 to 31.12.2013. At the time of making the assessment by the Deputy Commissioner was not aware this situation and based on the available information and understanding that the assessment made on 'Profit from Trade or Business' and assessed the Company under section 3(a) of the Act.*

Also, the representative of the Respondent stated that, at the Appeal hearing stage, it was revealed that the commercial operation history of the Company as that, there were no commercial operations during the assessment period, the other income derived from investment and dividend cannot be considered as 'profits from Trade or Business' under section 3(a) of the Act. Based on these grounds it was determined by the CGIR that, the identified investment income could be considered under section 3(e) of the Act. "

It should be noted that income tax is assessed not merely by reference to the Appellant's commercial operations, but by reference to its business operations as a whole. Accordingly, the Appellant has commenced its business activities within the taxable year 2013/2014, and is liable for income tax in the said year based on its profits/losses. Furthermore, granting of loans and earning interest is an integral part of the business of banking. Once the bank has commenced its operation it is immaterial whether it has commenced commercial operation, as the banking business operation has already commenced and the tax liability has already arisen.

In these circumstances, the interest received by the Appellant from the commencement of the business must be regarded as intrinsic to its banking business, notwithstanding that the commercial operations had not yet commenced. Moreover, it is unreasonable to confine the scope of "banking business" by rigid reference to the date on which the commercial operations begun, as such an approach would unreasonably narrow the meaning of section 3(a) of the Inland Revenue Act, No. 10 of 2006, given that a bank cannot be established and made operational instantaneously.

On this basis, I answer the question of law II in the Negative and the question of law IV in the Affirmative.

Question of Law V

V. Does general administration and management expenses incurred by the Company in preparation of production of income during the period where a provisional banking license was issued to the Appellant constitute outgoings and expenses incurred in the banking business?"

It is the Appellant's position that it is entitled to a deduction under section 25(1) of the Inland Revenue Act, No.10 of 2006. This is on the basis that the administration and management expenses were incurred by the Appellant in the course of establishing the commercial venture for the production of profits/ income during the period in which the provisional banking license had been granted.

However, the TAC in its determination has held the following;

> *"Further, I observed that the allowable 'expenses/outgoing under the section 25(1) of the Act and the 'Company formation expenses' under section 25(1)(1) of the Act are not possible to incur, as there were no commercial operations of the bank during the assessment period."*

According to the letter dated 6th September 2011, the Central Bank of Sri Lanka has granted provisional approval for the Appellant subject to its conditions. It is therefore the Appellant's position that the provisional license was issued to ensure that the necessary conditions were in place for the bank to carry on its commercial activities, and that, in these circumstances, the management expenses incurred represent expenditure laid out for the production of taxable income. Further, the Provisional license has been extended and subsequently the banking license was granted. This has been clearly agreed upon by the Respondent in the determination of TAC, in the following manner.

> *"The representative of the Respondent stated that, at the Appeal hearing stage in the TAC, the Appellant has provided some documents related to the registration of the*

Company as a licensed commercial bank along with the written submission dated 20.04.2022. The following information could be observed through these documents.

(a) The Director, Bank Supervision, Central Bank on 06th September 2011, stated that subject to fulfillment of the terms and conditions stipulated therein, 'Provisional Approval status is granted to establish the Bank with effect from that date.

(b) The Director, Bank Supervision, Central Bank on 08th January 2013 stated, the validity period of 'Provisional Approval has been extended till 31.03.2013

(c) The Director, Bank Supervision, Central Bank on 25th March 2013 stated, the necessary steps that would be taken to issue 'banking license' in order to commence banking business.

Information in these documents have further revealed that the Company has started banking business from 21st January 2014 and was not involved in banking business from 01.01.2013 to 31.12.2013. At the time of making the assessment by the Deputy Commissioner was not aware this situation and based on the available information and understanding that the assessment made on 'Profit from Trade or Business' and assessed the Company under section 3(a) of the Act."

In light of the foregoing, this Court is of the view that the expenses incurred by the Appellant in establishing its business operations were incurred for the purpose of producing profits and were incurred at a time when the provincial license had already been granted.

The section 25(1) of IRA 2006, which provides for the Deductions allowed in Ascertaining profits and income, reads as follows;

"(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—

a) *an allowance for depreciation by wear and tear of the following assets acquired, constructed or assembled and arising out of their use by such person in any trade, business, profession or vocation carried on by him"*

The section 25(1) of IRA 2006 states that, subject to the limitations in subsections (2) and (4), all outgoings and expenses that a person actually incurs in generating any profit or income from any source may be deducted in computing such profit or income. It further states that these allowable deductions include, among others, a depreciation allowance in respect of wear and tear of specified assets that have been acquired, constructed, or assembled, where those assets are employed by that person in the course of carrying on a trade, business, profession, or vocation.

In consideration of the above, it need to be noted that the expenses incurred by a company, in the production of their income shall be deducted if such assets have been employed by the said company in any trade, business, profession, or vocation. However, the Respondent and TAC have adopted a contrary position.

Although the Appellant's commercial operations had not commenced during the year of assessment in question, its banking business had commenced for the relevant taxable year. Accordingly, the expenses incurred by the Appellant for the purpose of producing income during the period in which the provincial license had been granted constitute expenses of the banking business within the meaning of section 25(1) of IRA 2006. Consequently, such expenses pertaining to the operation of the banking business are deductible pursuant to the aforementioned section.

In light of the foregoing, I answer Question of Law V affirmatively.

CONCLUSION

When considering the facts and the circumstances of the case, in line with the materials presented before this court, I am of the view that the questions of law raised by the Appellant shall be answered in the following manner.

Question of law I – Negative

Question of law II – Negative

Question of law III – Negative

Question of law IV – Affirmative

Question of law V – Affirmative

Accordingly, the appeal is allowed.

The determination of the TAC dated 30th of March 2023 and the determination of the Respondent dated 28th of May 2018 is overturned. Further, the Notice of assessment dated 30th of May 2016, issued by the Deputy Commissioner of the Department of Inland Revenue is hereby annulled.

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

Judge of the Court of Appeal

Annalingam Premashanker J.

I agree

Judge of the Court of Appeal