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/019/2015 by the Tax Appeals Commission under Section 170 of the Inland Revenue Act No. 10 of 2006.

Ceylon Shell Flour Limited.,
No. 148/1, Kynsey Road,
Colombo 8.

Appellant

Case No. CA(TAX) 03/2016
TAC Case No. TAC/IT/019/2015

Vs.

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

Respondent

Before: Janak De Silva J.

N. Bandula Karunarathna J.

Counsel:

F.N. Gunawardena with E.D. Wickremanayake for the Appellant

Vikum De Abrew SDSG for the Respondent

Written Submissions tendered on:

Appellant on 02.10.2018

Respondent on 12.10.2018

Argued On: 24.09.2019

Decided on: 29.05.2020

Janak De Silva J.

The Appellant is a Private Limited Liability Company incorporated and domiciled in Sri Lanka. Its principal activity is the production of Coconut Shell Flour which is a fine powder manufactured for the export market by grinding the coconut shells using a special machine. The raw material used for this production is the coconut shell which the Appellant purchases from an associate company called S.A. Silva & Sons Pvt. Ltd. dealing in the production of desiccated coconut.

The Appellant filed its tax returns for 2007/08, 2008/09, 2009/10 and 2010/11 and claimed tax exemption for the profits of the above undertaking to produce Coconut Shell Powder. The assessor rejected the returns on the ground that the coconut shell is not an agricultural produce within the meaning of section 16(2)(a) of the Inland Revenue Act No. 10 of 2006 as amended (IRA 2006) and that the conversion of coconut shell into Coconut Shell Powder cannot be treated as an exempt undertaking in terms of section 16 (2)(c) of the IRA 2006 since Coconut Shell Flour is not gazetted by the Commissioner-General of Inland Revenue in terms that section.

The Appellant appealed to the Respondent who held that the assessments for the years 2007/08 and 2008/09 are time barred. However, the Respondent held that the assessments for the years 2009/10 and 2010/11 are valid and that the exemptions in sections 16(2)(b) and (c) of IRA 2006 is not available to the Appellant.

Aggrieved by this determination, the Appellant appealed to the Tax Appeals Commission (TAC) which dismissed the appeal.

Upon the application of the Appellant, the TAC has forwarded this Case Stated to Court containing the following questions of law:

(1) Whether the assessment issued for the year of assessment 2009/2010 is out of time since it was not determined by the Tax Appeals Commission?

(2) Whether the assessment is not validly made in terms of section 163(3) of the Inland Revenue Act No. 10 of 2006?

(3) Whether the production of coconut shell flour made out of coconut shells is an agricultural produce in terms of section 16(2)(b) of the Inland Revenue Act No. 10 of 2006?

Time Bar of Assessment

The Appellant filed its income tax returns for the period 2009/10 on 30th November 2010. On or around 2nd November 2012 the assessor issued an intimation letter under section 163(3) of IRA 2006. On or around 30th November 2012 the Respondent issued notice of assessment on the Appellants for the year of assessment 2009/10.

The Appellant contends that in terms of section 106(1) of the IRA 2006 as originally enacted a return must be filed on or before the 30th day of September immediately succeeding the end of that year of assessment. Once a tax payer files a return on time, section 163(5) of the IRA 2006 as originally enacted prohibits an assessment being made after the expiry of eighteen months from the end of that year of assessment.

Accordingly, if no change was made to the legal regime, the assessment of the Appellant for the year of assessment 2009/10 should have been made on or before 30th September 2011.

However, section 163(5) of IRA 2006 was amended by the Inland Revenue (Amendment) Act No. 19 of 2009 and the words "thirtieth day of September" and "expiry of eighteen months" were replaced with the words "thirtieth day of November" and "expiry of a period of two years" respectively. This change in the legal regime was made well before the Appellant filed its return for the year of assessment 2009/10 on 30th November 2010. The Appellant does not challenge the application of this amendment to the instant case. Then the assessment should have been made on or before 31st March 2012.

Yet, there was another amendment made to section 163(5) of the IRA 2006 by Inland Revenue (Amendment) Act No. 22 of 2011 which came into effect from 1st April 2011, by which the words "from the end of that year of assessment" with the words "from the thirtieth day of November of the immediately succeeding year of assessment". Then the Respondent had time until 30th November 2012.

However, the learned counsel for the Appellant contended that the 2011 amendment is inapplicable to the year of assessment 2009/10 for at least two reasons. Firstly, that it was brought into effect on 1st April 2011 which is the commencement of the year of assessment 2011/12 and thus giving a clear indication that it was sought to be made applicable from the year of assessment 2011/2012 onwards. Secondly, it was submitted that at the time the Appellant submitted the return on 30th November 2010 this was not applicable and therefore it will not apply.

A similar issue arose some time ago when the amendment to the IRA 2006 in 2009 was the subject matter in *Seylan Bank PLC. v. The Commissioner General of Inland Revenue* [CA(Tax) 23/2013, C.A.M. 23.05.2015]. In that case this Court held that irrespective of whether the Assessee had to submit the tax return on or before the 30th September or 30th November 2009, the Assessor can send the assessment to the Assessee within two years immediately succeeding that year of Assessment. The Court further considered the amendments made to section 163 of IRA 2006 by Act Nos. 22 of 2011, 18 of 2013 and 8 of 2014. It held that the two-year period given to the Assessor to send the assessment against the Assessee was to start from the end of the year of assessment originally, which is the 31st of March, every year. This date (the starting day of the period) has been further pushed down to the thirtieth day of November of the immediately succeeding year of assessment by Act No. 22 of 2011. The Court also held that section 163(5) of IRA 2006 is a procedural law and that even if the amendment has retrospective effect, it applies, if the amendment is only on procedural law.

Two judges sitting together as a rule follow the decision of two judges. Where two judges sitting together find themselves unable to follow a decision of two judges, the practice in such cases is also to reserve the case for the decision of a fuller bench [*Walker Sons & Co. (UK) Ltd. v. Gunatilake and others* (1978-79-80) 1 Sri. L.R. 231]. In any event, I am of the view that the reasoning in *Seylan Bank PLC. v. The Commissioner General of Inland Revenue* (supra) is sound and compelling and sets out the correct position of the law.

In any event, in my view, the time bar in Section 163(5)(a) of the IRA is procedural. In *A.G. v. Vernazza* [(1960) 3 All.E.R. 97 at 100] it was held that if the new act effects matter of procedure only, then prima facie, it applies to all actions, pending as well as future. This was reiterated in *Blyth v. Blyth* [(1966) 1 All.E.R. 524 at 535] where Lord Denning held that the rule that an act of Parliament is not to be given retrospective effect does not apply to statutes which only alters the form of procedure.

The only remaining issue is whether the assessment was made on or before 30th November 2012. It is observed that the intimation letter under section 163(3) of IRA 2006 is dated 2nd November 2012.

Section 163(3) of IRA 2006 requires the assessor to inform the person who submitted the return the reasons for not accepting his return. Such intimation is possible only after the Assessor makes an Assessment.

The distinction between the "Assessment" and "Notice of Assessment" has been clearly recognized in *Commissioner of Income Tax vs. Chettinad Corporation Ltd.* (55 N.L.R. 553 at 556) where Gratiaen J. held:

> "The distinction between an Assessment" and a "notice of assessment" is thus made clear: the former is the departmental computation of the amount of tax with which a particular Assessee is considered to be chargeable, and the latter is the formal intimation to him of the fact that such an assessment has been made."

This was quoted with approval by the present Court of Appeal in *Ismail vs. Commissioner of Inland Revenue* [(1981) 2 Sri. L.R. 78].

Although *Commissioner of Income Tax v. Chettinad Corporation Ltd.* (supra) was decided upon a consideration of the relevant provisions of the Income Tax Ordinance No. 2 of 1932 as amended the distinction made therein between "assessment" and "notice of assessment" has been maintained in the 2006 Act.

In fact, Samarakoon C.J. in *D.M.S. Fernando and another vs. Ismail* [(1982) 1 Sri. L.R. 222 at 228) held:

> "The Assessment so made in terms of section 93(2) must be followed by a Notice of Assessment in terms of section 95. That is the first time that the Assessee is apprised of the estimated income and taxable wealth and he must then know the reasons for non-acceptance of his return. It appears to me therefore that the duty to communicate reasons can be discharged by sending the reasons simultaneously with the Notice of Assessment."

Since the intimation letter under section 163(3) of IRA 2006 is dated 2nd November 2012 clearly the assessment was made at or before that and therefore the assessment for the year 2009/10 is not time barred.

Validity of Assessment

The Learned Counsel for the Appellant contended that the intimation letter issued under section 163(3) of the IR Act by the Assessor has merely reproduced the section 16 of IRA 2006 and states that coconut shell flour is not "any agricultural produce as mentioned in (a) and (b) of the above". It is submitted that this communication is invalid in law.

All what section 163(3) of IRA 2006 requires is for the assessor to intimate to the person submitting the return, reasons for not accepting the return. It is observed that the Appellant did not in the return declare the reasons for seeking the exemption. The Assessor has on the available information concluded that the Appellant is seeking an exemption in terms of section 16(3)(c) of the IR Act. The Assessor has given an adequate indication to the Appellant as to the reasons why the return has been rejected thus satisfying the requirements in section 163(3) of IRA 2006 [*Gunaratne v. Jayawardane and Others* (Sri Lanka Tax Cases Vol. IV page 246)].

Section 16 (2) (b) of IRA 2006

Section 16 of IRA 2006 as amended by Inland Revenue (Amendment) Act No. 19 of 2009 reads:

"(1) The profits and income within the meaning of paragraph (a) of section 3, other than any profits and income from the disposal of any capital asset, of any person or partnership from any agricultural undertaking carried on in Sri Lanka, shall be exempt from income tax for each year of assessment within the period of five years, commencing on April 1, 2006.

(2) In this section "agricultural undertaking" means -

(a) an undertaking for the purpose of the production of any agricultural, horticultural or any diary produce;

(b) an undertaking for the cleaning, sizing, sorting, grading, chilling, dehydrating, packaging, cutting, canning for the purpose of changing the form, contour or physical appearance of any produce referred to in paragraph (a), in preparation of such produce for the market; or

(c) any undertaking for the conversion of any produce referred to in paragraph (a) into such product as may be specified by the Commissioner-General, by Order published in the Gazette."

The analysis must begin by ascertaining the scope of section 16(2)(a) of IRA 2006 which in my view must be given a wide meaning and will cover any agricultural, horticultural or any diary produce. One cannot qualify it as any primary agricultural produce. In using the word *any*, the legislature has given a clear indication that it intended to provide for a wider application.

Section 16(2) (c) of IRA 2006 is specific to products which are produced by conversion of any produce referred to in sub-section 16(2) (a) of IRA 2006 into another product. What is contemplated is a *conversion* of one product into another product. Examples are Yoghurt and curd which requires a process of conversion to be made to milk. Such products qualify for tax

exemption only if gazetted in terms of this sub-section. In this situation, the conversion process changes the character of the produce in sub-section 16(2) (a) of IRA 2006 into another product.

In my view what is envisaged in sub-section 16 (2) (b) of IRA 2006 is a situation where the produce referred to in section 16(2) (a) therein retains its character even after the acts referred to section 16 (2) (b) therein are performed. This becomes clear when one considers the words "for the purpose of changing the form, contour or physical appearance of *any produce referred to in paragraph (a)*, in preparation of *such produce* for the market".

The Appellant grinds coconut shells and makes coconut shell flour which is a different product to the coconut shell. Therefore, in my opinion coconut shell flour is not an exempt item in terms of section 16 (2) (b) of IRA 2006.

For the foregoing reasons, we answer the questions of law as follows:

(1) Whether the assessment issued for the year of assessment 2009/2010 is out of time since it was not determined by the Tax Appeals Commission? **No.**

(2) Whether the assessment is not validly made in terms of section 163(3) of the Inland Revenue Act No. 10 of 2006? **No.**

(3) Whether the production of coconut shell flour made out of coconut shells is an agricultural produce in terms of section 16(2)(b) of the Inland Revenue Act No. 10 of 2006? **No.**

For the reasons aforesaid, this Court confirms the Determination of the TAC.

The Registrar is directed to send a certified copy of this judgment to the TAC.

Judge of the Court of Appeal

N. Bandula Karunarathna J.

I agree.

Judge of the Court of Appeal