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

In the matter of an application of a Case Stated under and in terms of Section 122 of the Inland Revenue Act No. 28 of 1979 (as amended)

Royal Ceramics Lanka PLC,

No. 10 R.A. De Mel Mawatha,

Colombo 03.

APPELLANT

Case No. CA (TAX) 05/2008 **Vs.**

Board of Review Case No. BRA/517/SCA 214

The Commissioner General of Inland Revenue,

The Department of Inland Revenue,

Inland Revenue Building,

Sir Chittampalam A. Gardiner Mawatha,

Colombo 02.

RESPONDENT

Before: Janak De Silva J.

Achala Wengappuli J.

Counsel:

Nihal Jayamanne P.C. with Sanjeewa Jayawardena P.C. and Rajeeva Amarasuriya for the Appellant

Vikum De Abrew SDSG for the Respondent

Argued On: 05.12.2018 and 07.12.2018

Written Submissions tendered on:

Appellant on 24.05.2018, 21.01.2019 and 06.05.2019

Respondent on 24.05.2018 and 25.03.2019

Decided on: 12.05.2020

Janak De Silva J.

The Appellant is a public quoted company and was approved as an industrial undertaking of a pioneering nature in regard to industrial products under section 17C of the Inland Revenue Act No. 28 of 1979 as amended (IRA 1979) by Gazette notification no. 657 dated 5th April 1991.

The Appellant incurred trade losses for the years of assessment 1993/94 and 1994/95 but earned interest income for the same period. In its returns the Appellant deducted the trade losses from the income earned from interest.

The Assessor acting in terms of section 115(3) of the IRA 1979 rejected the returns by disallowing the trade losses deducted from the interest income from fixed deposits as not being in accordance with section 29(2)(b) of the IRA 1979 and issued fresh assessments.

The Appellant appealed to the Respondent against the assessment which was rejected and then a further appeal was preferred to the Board of Review which was also rejected.

Initially this Case Stated contained only the following question of law:

(1) Is the Assessee entitled to deduct losses incurred for the year of assessment 1993/94 and 1994/95 in carrying on industrial undertaking qualified to be exempted from the payment of income tax in respect of profits of such undertaking, despite the provisions contained in section 29(2)(b) of the IRA 1979?

Later an application was made to Court for the amendment of the Case Stated by including 19 questions of law. It appears that on 12.01.2010 the learned President's Counsel for the Petitioner had informed that only one issue has been forwarded to Court for opinion although 19 issues of law were submitted to the Board of Review. Thereafter since the learned Senior State Counsel appearing for the Respondent informed that he has no objection to the amendment of the issues of law to be considered by the Board of Review, Court directed the Board of Review to consider the amendment of issues of law as requested by the Appellant. By letter dated 04.05.2010 the Board of Review amended the Case Stated to include all 19 issues of law proposed by the Appellant.

The Appellant preferred this Case Stated in terms of section 122 of the IRA 1979. Section 122(6) therein states that any two or more judges of the Court of Appeal may *hear and determine any question of law arising on the stated case*. Similar formulation is found in section 11A (6) of the Tax Appeals Commission Act No. 23 of 2011 as amended.

The words "hear and determine any question of law arising on the stated case" first appeared in section 74(5) of the Income Tax Ordinance No 2 of 1932 which was interpreted by Basnayake C.J. in *R.M. Fernando v. Commissioner of Income Tax* (Reports of Ceylon Tax Cases, Vol. I, page 571 at 577) to mean that it requires the Court to hear and determine any questions of law arising on the stated case and not any question or questions formulated by the Board. Previously in *M.P. Silva v. Commissioner of Income Tax* (Reports of Ceylon Tax Cases, Vol. I, page 336 at 338) Canekeratne J. having considered section 74(5) of the Income Tax Ordinance No 2 of 1932 held that "all questions that could be raised on the whole case was intended to be left open". The learned Judge chose to follow the dicta in *Ushers Wiltshire Brewery v. Bruce* [(1915) A.C. 433 at 465,466].

In *Commissioner of Income Tax v. Saverimuttu Retty* (Reports of Ceylon Tax Cases, Vol. I, page 103 at 109) Abrahams C.J. did make a similar statement by stating:

> "Incidentally there was no reference to us on this point by the Board of Review, since that point was not put to the Board when they were called upon to adjudicate in appeal, but we are not, of course precluded from considering any point upon which the actual decision of the Board might be upheld, no matter what might have been their reasons for arriving at that decision".

It is an established rule of interpretation that the legislature is presumed to know the law, judicial decisions and general principles of law. *Bindra's Interpretation of Statutes*, 10th ed., page 235 states as follows:

> "The legislature must be presumed to know the course of the legislation, as well as the course of judicial decisions in the country, *a fortiorari* of the superior courts of the country. It is a well-settled rule of construction that when a statute is repealed and re-enacted, and words in the repealed statute are reproduced in the new statute, they should be interpreted in the sense which had been judicially put on them in the repealed Act, because the legislature is presumed to be acquainted with the construction which courts have put upon the words, when they repeat the same words, they must be taken to have accepted the interpretation put on them by the court as correctly reflecting the legislative mind."

In *Nilamdeen v. Nanayakkara* (76 N.L.R. 169) it was held that it is a well-known rule of construction that where the legislature uses in an Act a legal term which has received judicial interpretation, it must be assumed that the term is used in the sense in which it has been judicially interpreted. There is also another rule of construction that where the words of an old statute are made part of a new statute, the legal interpretation which has been put upon the former by courts of law is applicable to those same words in the new statute.

Accordingly, this Court is not bound to answer any question of law formulated by the Board of Review and can hear and determine any questions of law arising on the Stated Case. I am of the view that the following question of law will address all the points raised by the Appellant namely:

(1) Is the Appellant entitled in terms of section 29(2)(b) of the IRA 1979 to deduct trade losses from the interest income from fixed deposits losses incurred for the year of assessment 1993/94 and 1994/95 in carrying on industrial undertaking qualified to be exempted from the payment of income tax in terms of section 17C (1) of the IRA 1979?

Section 17C (1) of the IRA 1979 after the amendment made by Act No. 63 of 1992 reads:

> "17C (1). The profits and income within the meaning of paragraph (a) of section 3 (other than any profits and income from the sale of capital assets), of any company referred to in subsection (2), shall be exempt from income tax for a period of five years reckoned from the year of assessment in which such company commenced to make profits in respect of its transactions in that year".

There is no dispute that the Appellant is a company falling within this section. The main issue is the interpretation of section 29(2)(b) of the IRA 1979. The portion relevant to this matter reads:

> "29(2)(b). There shall be deducted from the total statutory income of a person for any year of assessment the amount of a loss (other than a capital loss or loss referred to in subsection (7), or a loss referred to in subsection (7A)), incurred by him in any trade, business, profession or vocation during any year of assessment, **which if it had been a profit would have been assessable under this Act**, or the Inland Revenue Act No. 4 of 1963, and which has not been allowed against his statutory income of a previous year under those Acts…" (Emphasis added).

The learned President's Counsel for the Appellant submitted that in interpreting the relevant provisions Court must be guided by the established rule in the interpretation of statutes levying taxes and duties, of not extending the provisions of the statute by implication, beyond the clear import of the language used or to enlarge their operation in order to embrace matters not

specifically pointed out [*Vallibel Lanka (Pvt) Limited v. Director General of Customs* [(2008) 1 Sri.L.R. 219 at 223]. The attention of Court was also drawn to the observations of Brewer J. in *Stahl v. Education Assn of the Methodist Church* cited in N S Bindra's Statutory Interpretation [9th Ed. 1049]

It is not in dispute that the Appellant commenced making profits in the year of assessment 1996/97, whereas the years of assessment relevant to this matter is 1993/94 and 1994/95.

The Appellant therefore contends that it is entitled to the permitted deduction in section 29(2)(b) of the IRA 1979.

This section is included in chapter VI of the IRA 1979 which deals with ascertainment of the assessable income. It is in effect an exemption since it permits a deduction to be made from the statutory income in ascertaining the assessable income and must be strictly construed.

Provision providing for exemption in taxing statutes has to be construed strictly; where two views of the exemption are possible, it need not necessarily be construed in favour of the subject [*State Level Committee v. Morgardshammar India Ltd.* AIR 1996 SC 524]. The Supreme Court of India rejected the view that where two views of the exemption notification are possible, it should be construed in favour of the subject [*Collector of Central Excise, Bombay v. Parle Exports Pvt. Ltd.* (1989) 1 SCC 345].

In case of an ambiguity or doubt regarding an exemption provision in a fiscal statute, the ambiguity or doubt will be resolved in favour of the revenue and not in favour of the assessee [*Novopan India Ltd. v. Collector of Central Excise and Customs* (1994 Supp (3) SCC 606), *Liberty Oil Mills Pvt. Ltd. Bombay v. Collector of Central Excise, Bombay* (1995) SCC 451].

Sutherland in his *Statutory Construction* [Vol. 3, 296 (3rd Ed.)] states:

> "As a general rule grants of tax exemptions are given a rigid interpretation against the assertion of the tax-payer and in favour of the taxing power. The basis for the rule is the same as that supporting a rule of strict construction of positive revenue laws - that the burdens of taxation should be distributed equally and fairly among the members of society".

Section 29(2) (b) of the IRA 1979 Act applies on a hypothesis. It only becomes applicable on the assumption that a business has a profit, though in fact it is a loss.

It is true that in fact the Appellant commenced making profits in the year of assessment 1996/97 whereas the years of assessment relevant to this matter is 1993/94 and 1994/95. However, for Section 29(2) (b) of the IRA 1979 Act to apply it must be assumed that the Appellant made profits in 1993/94. The Appellant would not, in view of the exemption granted by section 17C (1) of IRA 1979 being then engaged, then have been assessable under section 3(a) of the IRA 1979 Act. Hence the trade losses incurred during this period would not be deductible in terms of section 29(2) (b) of the IRA 1979 Act.

The learned President's Counsel drew the attention of Court to the *Occam's Razor* principle and submitted that the interpretation suggested by the Respondent must be rejected in favour of the position contended to by the Appellant as it has the least assumptions.

Occam's Razor principle is a philosophical problem-solving principle which essentially means the simplest solution is most likely the right one. It states that when presented with competing hypotheses that make the same predictions, one should select the solution with the fewest assumptions.

However, philosophy must give way to statutory provisions. In this case, the hypothesis in section 29(2) (b) of the IRA 1979 Act is a statutory compulsion and cannot be replaced by what may be perceived to be the ideal position.

The learned President's Counsel also drew the attention of Court to the decision in *Commissioner General of Excise v. Seylan Development PLC* [CA (Tax) 10/2014, C.A.M. 06.04.2017]. However, the facts in that case are different to the instant case.

It was further contended that if the Appellant was not entitled to any exemption, it would have had the benefit of resorting to section 29(2) (b) of the IRA 1979 which it has been deprived by the interpretation adopted by the authorities to an exemption granted to the Appellant and as such it is most unfair, unreasonable, skewed and anomalous.

However, in *Cape Brandy Syndicate v. CIR* [(1930) 12 TC 358] Justice Rowlatt held:

> "It means that in taxation you have to look simply at what is clearly said. there is no room for any intendment; ***there is no equity about a tax***: there is no presumption as to a tax; you read nothing in; you imply nothing, but you look fairly at what is said clearly and that is the tax" (Emphasis added).

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

(1) Is the Appellant entitled in terms of section 29(2)(b) of the IRA 1979 to deduct trade losses from the interest income from fixed deposits losses incurred for the year of assessment 1993/94 and 1994/95 in carrying on industrial undertaking qualified to be exempted from the payment of income tax in terms of section 17C (1) of the IRA 1979? **No.**

Accordingly, we confirm the assessment determined by the Board of Review.

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

Judge of the Court of Appeal

Achala Wengappuli J.

I agree.

Judge of the Court of Appeal