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

In the matter of a case stated under section 170 of the Inland Revenue Act, No.10 of 2006 (as amended.)

Rhode Nielson A/S

Having its registered address at

Nyhan 20,

DK- 1051,

Kobenhaven K.

APPELLANT

C.A. TAX/ 28/2014

Tax Appeals Commission No:

TAC/ OLD/ IT/042

-Vs-

Commissioner General of Inland Revenue

Department of Inland Revenue,

Sir Chittampalam A. Gardiner Mawatha.

Colombo 02.

RESPONDENT

BEFORE : **A.H.M.D. Nawaz, J. (P/CA) &**

Sobhitha Rajakaruna, J.

COUNSEL : Faisz Musthapha, PC. with Riad Ameen, Pratheepa Balendran and Rushitha Rodrigo instructed by Paul Ratnayake Associates for the Appellant.

Farzana Jameel PC ASG with Chaya Sri Nammuni SSC for the Respondent.

Decided on : 25.11.2020

A.H.M.D. Nawaz, J. (P/CA)

The case stated which relates to two years of assessments namely 2005/2006 and 2006/2007 raises an interpretation of Section 95 (1) of the Inland Revenue Act No 10 of 2006 (IRA 2006), which mirrors the same language as Section 90 (1) of the IRA 2000 (IRA 2000). Both these two sections which are couched in identical terms are relevant to the two years of assessments in issue.

The two provisions in their entirety entail that a withholding tax liability may be imposed on certain payments falling due under the circumstances specified therein.

The Appellant *Rhode Nielson A/S* -a Danish non-resident company which supplied contractual services to the *Sri Lanka Land Reclamation and Development Corporation* (*SLLRDC*) denies any such withholding tax liability for the two years of assessment and both the Commissioner General of Inland Revenue (CGIR) and Tax Appeals Commission ("TAC") have affirmed that such a withholding tax liability exists on the part of the assessee- the Appellant company.

It is the determination of the TAC dated 22.08.2014 that is being impugned in this case stated. As one peruses both sections in the 2000 and 2006 Inland Revenue Acts, one salient fact emerges. Any deduction as a result of the imposition of withholding taxes is cast upon certain payors who are identified in the two sections and it is only when they make certain types of *payments* from Sri Lanka, it becomes their entitlement to withhold a specified percentage of the payments so made.

I must pause to point out what I venture to call *payments* as above is not confined only to *payment or transmission of money* out of Sri Lanka. The question arises in this case whether a crediting of a ledger in favour of a person outside Sri Lanka will also attract a withholding tax liability within the meaning of section 95 (1) of IRA 2006.

The necessity to ascertain the meaning of the word "crediting" arises because both these two sections use the words *"pays or credits"* as the mode of payment. What does

the legislature mean in the two charging sections when it employs the terms "*where any person or partnership in Sri Lanka pays or credits.....*"? The use of the word "pays" would connote that the transmission of money should take place across the border. What else did the legislature mean when the legislature uses the terms ."a person or partnership **in Sri Lanka** .....*credits* to any person or partnership ***out of Sri Lanka....***" These are questions germane to the interpretation that is called for in this case stated.

As I said both sections 90 (1) and 95 (1) speak the identical language as regards withholding tax liability-a legacy that has passed into the linguistic collocation of the two sections as a result of the old section 44 of the Income Tax Ordinance. It is not only the words "*pays or credits*" but also a substantial part of the language of section 44 of the Income Tax Ordinance that are mirrored in the applicable provisions namely Section 90 (1) of the IRA 2000 (IRA 2000) and Section 95 (1) of the Inland Revenue Act No 10 of 2006 (IRA 2006).

In terms of these two sections it is the entitlement of a person in Sri Lanka to deduct withholding tax and pay it to the revenue when he pays or credits to a person out of Sri Lanka. The quintessential question before this Court is -Does the appellant *Rhode Nielson A/S*, a non-resident Danish company, become such a person in Sri Lanka within the ambit of the two sections for the respective years of assessment? The sections adjectivally qualify *the person in Sri Lanka* by stipulating other requirements and it is how the interpretation of the two provisions is engaged in the case.

Before I proceed to resolve the issue whether the Appellant is entitled to deduct withholding tax within meaning of the levying sections, let me set out the factual background of the presence of the Appellant in Sri Lanka and other allied facts.

Admittedly the Appellant *Rhode Nielson A/S* had entered into a contract dated 30/09/2005 with *SLLRDC* to extract and pump sea sand from offshore to a stockpile.

As the salient facts emerge, in order to provide the services that were contracted for, the Appellant-the Danish company did the following –

a) It had a project manager based in Sri Lanka.
b) It chartered ships from Denmark. These ships engaged in dredging, extracting and pumping of sea sand from offshore of Sri Lanka, which was thereafter stockpiled in Sri Lanka as required by *SLLRDC*.
c) Some of the ship owners were related companies to the Appellant Company, whilst others were non-related.

The ship owners themselves were not resident in Sri Lanka but they made available their ships for facilitating the discharge of the contractual obligations of the Appellant. So there were two contracts *in situ*. The first agreement was between the Appellant and the *SLLRDC*. This agreement was the underlying contract in which the Appellant had obligations to dredge, extract and pump sand for the benefit of *SLLRDC*. For the services rendered by the Appellant in Sri Lanka, the SLLRDC remitted the contractually agreed payments to the Appellant's bank account in Denmark.

The charter hire agreements constituted the second agreements the Appellant had with vessel owning companies. As the Respondent impliedly draws a conclusion in their written submissions dated 03.08.2018 to which I will shortly draw attention, the Appellant did not pay the overseas shipowners from Sri Lanka and it is plausible to infer that the Appellant paid the Shipowners in Denmark having regard to the fact that the *SLLRDC* had already transmitted the contractual payment due on the dredging contract. The payments made to the vessel owners find expressions under such terms as charter hire or rentals.

Be that as it may, in order to supervise and carry into effect its contractual obligations with the *SLLRDC*, the Appellant created a permanent establishment (PE) in Sri Lanka A permanent establishment is liable for income tax on the profits in Sri Lanka. As the

permanent establishment would usually have it, the Appellant did the following as the material available in the case indicates:

a) The Appellant had to register for Income Tax in Sri Lanka
b) It had obtained a Tax Identification Number (TIN) from the IRD.
c) The Appellant retained the services of an auditor (M/s Kreston MNS & Co.).
d) The Appellant had to file Income Tax Returns with the IRD along with a statement of accounts.

Admittedly the Appellant submitted returns of income for non-resident companies for the relevant years of assessment 2005/2006 and 2006/2007 and these returns which are marked as **R2 (a)** and **R2 (b)** respectively disclose losses for the years. There are also accompanying two statements of account or profit and loss accounts for the two years **R3(a)** and **R3(b)** which contain debits (expenses) and credits (income) on their respective left hand and right hand sides. The older legislation IRA 2000 applies to the year of assessment 2005/2006, whilst IRA 2006 applies to the year assessment 2006/2007.

It is relevant to note that ship rentals have been entered on the left hand side of each profit and loss account denoting them as expenses. In other words it is noteworthy that the ship rentals paid or payable to shipowners have been designated as debits on the profit and loss accounts- vide {**R3 (a)** and **R3 (b)**}. It would appear that it is these entries in the profit and loss accounts that led to an Assessor writing to the Appellant on 01.11.2007. In this letter marked **D 14A**, the Assessor *inter alia* states the following:

> *.....I wish to inform you that you have failed to deduct 20% withholding tax on payments made or payable to charter owners according to section 90 of the Inland Revenue Act No 38 of 2000 and section 95 of the Inland Revenue Act No 10 of 2006.*
>
> *This failure resulted that you have become a debtor to the Government of Sri Lanka. Therefore I am compelled to issue the assessments to recover the debt forthwith.*

Thus the basis of liability as alleged by the Assessor is quite clear. As a result of the disclosure of the rentals as expenses on the debit sides of the respective profit and loss accounts, there have been payments made or payable to the ship owners and accordingly sections 90 (1) of IRA 2000 and 95 (1) of IRA 2006 mandate that the Appellant must withhold 20% of these payments and remit them to the Revenue. There has been a failure to comply with the two sections and thus a debt has accrued to the State to recover the same. An assessment would follow the letter. This seems to be the tenor of the letter written by the assessor.

In short the pith and substance of the factual background giving rise to liability, as found by the assessor, is that the Appellant had made a payment to the shipowners or the payment had become due and upon the happening of these two events, the liability of the Appellant had kicked in within the meaning of these two sections. It is curious to note that the assessor was herself unsure as to which of these two events would constitute the taxable event on the facts and circumstances of the case. Hence her statement- *payments made or payable to charter owners.*

It is in this factual matrix that this Court has to discuss whether the legislative framework for liability had arisen.

Legislative Framework

Section 95 (1) of the IRA 2006 goes as follows

> *"Where any person or partnership in Sri Lanka pays or credits to any person or partnership out of Sri Lanka, any sum falling due as-*
>
> *(a) interest on debentures, mortgages, loans, deposits or advances;*
>
> *(b) rent, ground rent, royalty or annuity which is payable either in respect of property in Sri Lanka or out of income arising in Sri Lanka,*
>
> *whether such sum is due from him or from another person or from a partnership, he shall be entitled notwithstanding any agreement to the contrary, to deduct income tax at the appropriate*

rate specified in the Fourth Schedule to this Act, or where an agreement in force between the Government of Sri Lanka and the Government of any territory in which such person or partnership is resident for the relief of double taxation at the appropriate rate specified in such agreement, on such sum and the amount of tax so deductible shall be a debt due from such person to the Republic and shall be recoverable forthwith or may be assessed and charged upon such person in addition to any income tax otherwise payable by him under this Act...."

As I said before, the intendment of section 90(1) of IRA 2000 is on the same lines as section 95 (1) of IRA 2006. Sections 90 (1) and 95(1) can be truncated into their constituent elements.

The multifactorial ingredients that determine the liability of an entity such as the Appellant would be as follows:

1) the Appellant must be a person or partnership in Sri Lanka .
2) Such a person or partnership in Sri Lanka must pay or credit to any person who is out of Sri Lanka.
3) What is paid should be a sum falling due as one of those categories of payments specified in the sections. In this case it would be the rents paid to the shipowners in respect of charter hire.

Person or Partnership in Sri Lanka

The learned Additional Solicitor General (ASG) contended that the range of activities that the Appellant did in Sri Lanka make it a person in Sri Lanka. The fact that there was a permanent establishment through which the services of dredging and pumping sea sand were performed indicated that the appellant was a person in Sri Lanka. The creation of a permanent establishment was relied upon as indicative of a person in Sri Lanka. In its determination the TAC concludes that the Appellant had a liaison office though this Court does not find evidence to support that conclusion. Be that as it may, the term permanent establishment does not find expression in the IRA 2006. Both

Counsel drew the attention of court to the Double Taxation Treaty (DTT) between Sri Lanka and Denmark dated 22.12.1981-vide the extraordinary Gazette No 228/15 dated 20.01.1983. Article 5 of the DTT sets out the elements of a permanent establishment. Because the Appellant discharged services within Sri Lanka for a period more than 6 months it becomes a permanent establishment in terms of Article 5(2) (i) of the DTT.

Article 7 (1) of the DTT is worthy of note. A permanent establishment is liable for income tax on the business profits attributable to that permanent establishment, The evidence before the TAC does not conclusively establish that the entire proceeds of services from *SLLRDC* are attributable to the permanent establishment. This case is about whether the Appellant has to withhold tax and pay it to the Revenue when they make payment to a person outside Sri Lanka. Certainly this was not a case that dealt with income tax on profits. In fact there is evidence that the IRD made several attempts to impose income tax liability on the Appellant. One cannot gainsay the fact that only when those attempts failed, the IRD had recourse finally to Sections 90 and 95. The correspondence between the parties evidences it and there is no evidence that the Appellant made any profits attributable to the permanent establishment.

Instead the evidence led before the TAC reveals that *SLLRDC* never transmitted or paid any proceeds to the permanent establishment. There is no evidence that the permanent establishment in Sri Lanka transmitted money to the shipowners in Denmark.

One cannot read "***person in Sri Lanka***" in isolation. As I have set out the constituent elements of the charging section above, the person in Sri Lanka has to pay or credit to a person outside Sri Lanka and there is no evidence before the TAC that the permanent establishment made such payment or credited to a person outside Sri Lanka. The essence of the liability is that the payor in Sri Lanka paying someone outside Sri Lanka or the person in Sri Lanka crediting to a person outside Sri Lanka must withhold a deduction on the amount paid or credited. There is no evidence that

the permanent establishment in Sri Lanka paid or credited to a person out of Sri Lanka.

The evidence of Mrs. R.I. Silva, Deputy General Manager (Finance), SLLRDC was adduced before the TAC on 5/5/2010 and that evidence establishes that it was the SLLRDC which paid the Appellant in Denmark by transmitting the money to its bank account.

"Mr.Jayaneti: Were you aware of certain payments being made for the work of the Appellant's Company in respect of certain venture.

A: Yes

Q: *Can you refer your files and let us know for what work were payments made?*

A: *Payments were made for delivering sand to a stock pile of SLRDC in accordance with the contract agreement.*

Q: *How many instalments of payments?*

A: *We made two or three variation orders.*

Q: *Can you tell us the date of payment?*

A: The first payment was made on the 2nd February, 2006 and last payment was made November 2006.

Q: In what currency was the payment made?

A: In foreign currency namely Euro.

Q: To whom was it paid?

A: The payment was made to an Account in Denmark. Name of the Account is Rodhe Nielson A/S.

Mr.Jayaneti: Was the payment to Bank Accounts?

A: Yes. Bank Account.

Mr.Jayaneti: Mrs. Silva when you said Rhode Nielson account does it mean it is an account maintained by Rhode Nielson in a Bank in Denmark?

A: *Yes. It is the account it was credited and is an account maintained by Rhode Nielson in a Bank in Denmark."*

The proceeds for the services were thus transmitted by the *SLLRDC* to the Appellant in Denmark and the money thus merged into the bank balances of the Appellant deposited in Denmark. Then the corollary follows. It is plausible in these circumstances to assume that the Appellant credited the shipowners or paid them in Denmark.

In fact the mere presence of a permanent establishment will not suffice for purposes of withholding tax liability. In terms of sections 90 (1) and 95 (1) there is another constituent element that has to be proved by the revenue namely the person in Sri Lanka is the person who pays or credits to the person out of Sri Lanka. The phrase "**Person in Ceylon**" has been explained in "*Ceylon Income Tax Manual*" in the following manner-

"*(7) Person in Ceylon – meaning of phrase – Some difficulty may arise regarding the terms "person in Ceylon" and "person out of Ceylon". The Ordinance deliberately avoids the terms "resident" and "non resident", in view of the special meaning attaching to these terms under section 33. The phrase "person in Ceylon" must be read as meaning the actual individual who makes the payment, eg., the Secretary or Treasurer of a Company or Society, the Manager of a Bank, the Partner of a Partnership, & c.*" The emphasis is on the actual individual who makes the payment. That proof is wanting in this case. There is no evidence that the Permanent Establishment of the Appellant made the payment from Sri Lanka to the ship owners in Denmark.

Ceylon Tax Manual.

It has to be noted that the terms such as "person in Sri Lanka" and "payment out of Sri Lanka" have remained undefined in our tax statutes. Even IRA 2000 and IRA 2006

continue that legacy. But as far back as 1935, the IRD put forth what I would call an extra-statutory guideline known as the Ceylon Tax Manual.

The *"Ceylon Income Tax Manual"* elucidated what the phrase ***"person in Sri Lanka"*** must be taken to mean. The test is the location of **the individual officer of the company making the payment**. Likewise, the manual also illustrated that the ***"person out of Sri Lanka"*** must be decided by reference to the ***address to which the payment is sent or would be sent.***

I find that it is the IRD that has put forward the manual in the case. Having regard to the indicia given in the manual, there is no individual officer of the appellant company who could be identified in Sri Lanka as having made the payment to the shipowners, There is no evidence that there was an officer of the Appellant in Sri Lanka who was responsible for making the payment or crediting the payment to the shipowners in Denmark. The written submissions filed by the Respondent correctly points out that this Court is not bound by the manual which is neither law nor a subordinate legislation.

But it has to be accepted that statements of practice, guidance and manuals may be used to give a view on legislation or areas where uncertainties and difficulties have arisen to fill in the gaps where the legislation is drafted in broad terms, specially where a term used therein is not defined in the legislation. There is increasing use of guidance in view of the desire to legislate in broad terms and though the manual is completely outside the legislative system, it provides the taxpayer the confidence that a particular view has been taken of the legislation by the tax authorities. Now that it is the IRD that has produced the manual and relied upon it, it is estopped from denying the legal position it has articulated on the terms found in the statute-

Thus it is as plain as a pikestaff that the Appellant in Sri Lanka did not pay the ship owners in Denmark. As I said before, there is concession on the part of the learned ASG that the Appellant did not pay the ship owners, from Sri Lanka.

I would draw in aid paragraph 20 of the written Submissions dated 3/10/2018 filed by the Respondent which makes the following assertions. In fact, the contention is that there has been **no payment** by the **Appellant to shipowners at all**

Para 20

"Credited to a person outside Sri Lanka

20. *Next the question arises whether the person who pays/credits the amount is a person in Sri Lanka. The Appellant's view is that payment is by a company abroad. It is agreed, and evidenced by the charter agreement marked R1a (and others) that the parties, which are related companies, **have agreed for the payment to be made by inter-company account transfer. Therefore it is clear that there is no payment. There is a crediting.***

Having regard to the unassailed and uncontroverted evidence of the officer of the *SLLRDC*, one cannot fault the submission of the learned ASG that there was no payment made by the Appellant from Sri Lanka.

But there is one argument of the learned President's Counsel for the Respondent that commends itself to me. She contended or her contention was to the effect that though there is no payment to the overseas ship owners made from Sri Lanka, there is a crediting of the intercompany accounts in favor of the shipowners. She identified the crediting of the intercompany accounts as a trigger for withholding tax liability and her argument was that the moment a credit entry is made in the intercompany accounts, the Appellant can be charged with the withholding tax specified in the IRAs.

The learned ASG drew attention to the "Bareboat Charters" that had been produced marked **R1a** to **R1e** by IRD before the TAC. At the bottom of the page in the "Bareboat Charters" there is a cage titled "**Place of Payment**". In that cage there is the sentence "*By intercompany account. Charter invoiced at end of month*".

The tenor of the argument of the learned ASG is that because a crediting of the intercompany accounts has been agreed upon by the Appellant and the Ship owners, such a crediting would constitute the trigger for the withholding tax liability on the part of the Appellant. In fact I find that this self-same argument was also taken by the IRD before the TAC.

This argument is a natural corollary of a factual finding that there was no payment or evidence thereof of any payment being made from Sri Lanka to the ship owners. Confronted with the unassailable position that there is no payment made in Sri Lanka across passport control, there was no alternative for the Respondent but to draws in aid the alternative mode of payment specified in the sections namely ***crediting to a person out of Sri Lanka.*** The crediting of intercompany accounts had also been agreed upon by the Appellant and ship owners.

The terms "Pays or credits" in the charging sections

The basis of the argument of the Inland Revenue Department before the TAC and that of the learned ASG before this Court is the use of the expression "....***or credits to....***" in the charging sections. Upon a close scrutiny of the collocation of the words "***pays or credits to...***" in sections 90 (1) IRA 2000 and 95 (1) IRA 2006, it is crystal clear that the withholding tax liability is contingent upon payment made from Sri Lanka or crediting in Sri Lanka to a person outside Sri Lanka. Both modes of payment have been couched in the disjunctive alternatives and it is for this reason that I observed at the anterior part of the judgment that an interpretation of the word "***credits to***" in Section 95 (1) of Inland Revenue Act No 10 of 2006 has arisen in this case. What did the legislature contemplate when it used the phrase "***credits to a person out of Sri Lanka***"?

When the section uses the expression "***any person or partnership in Sri Lanka pays any person or partnership out of Sri Lanka...***", it is crystal clear that the legislature contemplated making an actual payment *in praesenti.* In other words it cannot mean

anything but actual payment to a recipient, whether it be by electronic transmission or payment *de praesenti*. There was no such a payment by the Appellant from Sri Lanka to the ship owners in Denmark. There was only the electronic payment from SLLRDC to the Appellant. What is important for withholding liability is the rent or income that was paid to the ship owner. But the argument for the Respondent is that even before rent is paid, that liability can arise. It can arise even when the ledger in favor of the ship owners is credited by the Appellant.

What did the legislature then mean when it used the words "***any person or partnership in Sri Lanka..... credits to a person or partnership out of Sri Lanka***"?

Can it mean the crediting of an intercompany company accounts as contended by the learned ASG?

The difference between **payment and crediting** emerges in sharp relief. Whilst **payment** would make available the funds immediately, the **crediting of a ledger** would be akin to creating a contingent liability in the account books. In other words the crediting of a ledger would create a liability without actual payment. The moment a credit entry is made in the ledger or account books, a contingent payment (a liability *de future*) in contradistinction to actual payment (liability *in praesenti*) is created and accordingly did the legislature also intend crediting to include crediting of a ledger?

I have looked at the Sinhala version of section 95 (1) and lexicons defining the word "credit" in its verbal sense, and I agree that the learned ASG is quite correct in her argument that the word "**crediting**" includes the crediting of a ledger. It would include the crediting of an intercompany account.

Black's Law Dictionary (11th Edition) defines the word "***credit***" at p 463 to mean in its verbal sense -" *to enter (as an amount) on the credit side of an account.*" The Oxford English Dictionary in it accounting usage defines "to Credit" to mean "to enter a credit in (an account) or in the account of (a person, etc.)."

An electronic version of that dictionary cites R. G. C. HAMILTON & J. BALL *Book-keeping* (1868) as having defined "credit" to mean "To enter on the Credit side." In its transitive modal of the word the Oxford English Dictionary also states that " to credit" To enter on or carry to the credit side of an account; to transfer to or deposit in an account....." So all lexicons in addition to the Sinhala version of IRA 2006 is to the effect that to credit would include making a credit entry.

Across the Palk Stait the Indian legislature put to rest this controversy by enacting express provision that a crediting of a ledger or making a credit entry would constitute the trigger for withholding tax liability-see Section 194A of the Indian Tax Act 1961 amended by its Finance Act, 1987. Chapter XVII of the Indian Act entitled Collection and Recovery of Tax deals with deduction at source (withholding tax) and several provisions of this chapter reflect this trend-see the Indian case of ***Commissioner of Income-Tax v Swarup Vegetable Products*** of the Allahabad High Court reported in 2005 SCC OnLine All 1890; (2008) 303 ITR 212 : (2005) 197 CTR 138. Moreover the Indian provisions also recognize that a person must be responsible for making the payment. This is what our own extra-statutory guide-the Ceylon Tax Manual requires.

So I hold thar even when a credit entry is made on a ledger in favor of a creditor, that would suffice for purposes of withholding tax liability within the meaning of the charging section. In other words the person in Sri Lanka who is responsible for paying must have credited to the person out of Sri Lanka.

Has this been proved before the TAC?

Therein lies the rub. Where did the crediting of the intercompany accounts in favor of the ship owners take place? The charging sections for withholding tax liability under our tax statutes mandate that the location of crediting must be in Sri Lanka-see sections 90 (1) and 95 (1). The location of actual payment as well as crediting the

ledger must lie in Sri Lanka. It is a question of fact that has to be established by the Respondent.

The profit and loss accounts that were produced before the TAC do not show a credit entry. Rather it shows a debit entry for charter hires. The Respondent must have established that a corresponding credit entry had been created in Sri Lanka for overseas shipowners. There is no evidence that the intercompany accounts were maintained in Sri Lanka nor did the Respondent prove that the crediting of the Intercompany Accounts took place in Sri Lanka.

The Inland Revenue Department must have necessarily led this item of evidence before the TAC. This item of evidence was not beyond the reach of the Inland Revenue Department. There is evidence that the *SLLRC* funds were transmitted to the Appellant in Denmark and one is driven to the inference that it is plausible that the intercompany accounts were maintained in Denmark.

There is no evidence at all before the TAC that the intercompany accounts were maintained in Sri Lanka. They were not even produced before the TAC. One cannot assume that a corresponding credit entry has been made. Tax liability does not arise on suppositions and assumptions. Taxing statutes are not interpreted on assumptions. The charging sections must be applied strictly when their words are unambiguous and leave no room for doubt.

In ***Film Exhibiters Guild v. State of Andhra Pradesh*** AIR 1987 AP 110 the Indian Court observed:

> *"A taxing statute, if it professes to impose a charge, its intention must be expressed in clear, unequivocal and unambiguous language. The court has to look at the language couched. A hunt into intention to find a charge is impermissible. No equitable construction of a charging section is to be applied. The charging section is to be construed strictly regardless of its consequences that may appear to the judicial mind to be. The burden is on the state to show*

that the subject is within the provisions of the Act. However, in construing the machinery provisions for assessment and collection of the tax to make the machinery workable ***ut res valeat petius quam pereat****, that is, the court would avoid that construction which would fail to relieve the manifest purpose of the legislation on the presumption that the legislature would enact only for the purpose of bringing about an effective result. It is not the function of the court to hunt out ambiguities by strained and unnatural meaning, close reasoning is to be adapted; harmonious construction is to be adhered to; all the relevant provisions are to be read together to gather the intention from the language employed, its context, and give effect to the intention of the legislature. Ingenious attempt to avoid tax is to be thwarted."*

These cannons of interpretation are consonant with the articulations of Rowlatt, J. in ***Cape Brandy Syndicate v. Inland Revenue Commissioners*** (1921) 1 KB 64 (at page 71)/ 12 TC 358 at page 366:

This leading principle was affirmed by the English Court of Appeal in (1921) 2 KB 403 and the following English cases have followed the principle enunciated in ***Cape Brandy Syndicate v. Inland Revenue Commissioners*** (supra)-to wit; ***Selection Trust Ltd. v. Devitt (Inspector of Taxes)*** [1945] 2 All ER 499 (HL) at 506-507; ***Amerada Hess Ltd. v. Inland Revenue Commissioners*** [2000] STC 397 at page 402; ***Jaggers (Trading at Shide Trees) v. Ellis (Inspector of Taxes)*** [1996] STC (SCD) 440 at page 444 and ***Johnson (Inspector of Taxes) v. The Prudential Assurances Co. Ltd.*** [1996] STC 647 at page 668.

In Sri Lanka the principle enunciated by Rowlatt, J. has been followed in ***Nanayakkara v. University of Peradeniya*** (1991) 1 Sri.LR 97; ***Trust Union Shipping Corporation v. Commissioner General of Inland Revenue*** (2003) 3 Sri.LR 43; ***The Manager, Bank of Ceylon, Hatton v. The Secretary Hatton Dickoya Urban Council*** (2005) 3 Sri.LR 1; and ***Vallibel Lanka (Pvt.) Limited v. Director General of Customs and three others*** (2008) 1 Sri.LR 219.

Sripavan, J. (President of the Court of Appeal) as His Lordship was then with the concurrence of Rohini Perera, J. echoed the consistent principle in ***Kalamazoo Systems Ltd v. The Commissioner General of Labour and 6 Others*** 2002 B.L.R 164 that nothing is to be read in and nothing is to be implied into fiscal legislation.

So assumptions and facts for which there is no evidence cannot be imported into when liability is sought to be imposed. Conceptually a withholding tax is a viacarious liability. The Appellant does not withhold on its income. It rather withholds a deduction on somebody else's income. It withholds on behalf of another namely the ship owners. But the words of the charging sections have to be strictly followed in order to charge someone with liability.

It has to be kept in mind that the task of interpreting a statute must be done within the framework and wording of the statute and in keeping with the meaning and intent of the provisions in the statute. A Court is not entitled to twist or stretch or obfuscate the plain and clear meaning and effect of the words in a statute to arrive at a conclusion which attracts the Court.

As I have pointed out, the sections do not get engaged on the facts and I take the view that the Appellant does not attract this liability. In a nutshell there is no evidence of a crediting that took place in Sri Lanka. The withholding tax liability is a liability at source and the source is unambiguously spelt out in the charging sections. The originating credit must take place in Sri Lanka and there is no evidence that a person responsible for paying the ship owner made the crediting of the intercompany accounts in Sri Lanka.

In such a factual matrix the TAC fell into an error and misdirected itself in concluding that the Appellant credited ship rentals to the ship owning companies in Sri Lanka. The TAC erred in not identifying the location of payment or crediting which is vital to the concept of tax deduction at source. The ingredients of liability have not been taken into account by the TAC and as a result their findings are not supported by

evidence. The profit and loss accounts do not show the location of crediting, leave alone the absence of crediting in the accounts.

In the circumstances I take the view that the assessments that were served on the appellant have to be nullified. There was also another argument that was taken up by the learned President's Counsel who appeared for the Appellant. He drew the attention of this court to another aspect of the definition in Section 95 (1) IRA 2006. He submitted that the liability under this section is not automatic. He laid emphasis on the words "shall be entitled... to deduct...". His argument was that the liability is not mandatory and it is merely optional. I have carefully considered the words used in the section and I take the view that the words "shall be entitled to deduct" connotes an entitlement vested with the right to deduct. Of course if ever the appellant or the person in Sri Lanka chooses to deduct withholding tax on the income that he pays or credits to a person out of Sri Lanka, the person out of Sri Lanka will have no objection to that course of action. That is why the section uses the words "shall be entitled to deduct".

The learned Additional Solicitor General argued to the contrary. She contended that the words "deductible" in the following paragraph after the word "and" in the section indicate that that liability is mandatory. The proviso to 95 (1) throws some light on the resolution of these rival arguments. The substance of the proviso is that only when a notice is given by the IRD to deduct, the payor is obligated to withhold and pay to the revenue. If deduction in Section 95 (1) is mandatory upon the happening of the taxable the events that are specified in the section namely payment or crediting, there is no reason for the existence of the proviso. Therefore there is merit in the argument of the learned President's Counsel for the Appellant that the deduction of withholding tax is only optional and not mandatory upon happening of the taxable events.

In any event it appears that the notices in this case sent to the Appellant seem to have been sent *ex post facto*. Long after the taxable event had occurred, it would appear that the demand to deduct was made.

Be that as it may, I proceed to set aside the determination of the tax appeals commission dated 22nd August 2014 and as the case stated demands of us in our jurisdiction, we proceed to nullify the assessments made on the appellant. The answers to the questions of law that have been stated to us would be as follows.

(i) Did the Commission err in law in arriving at the conclusions of fact that;

(a) the assessor informed the Appellant to deduct a 20% WHT in accordance with the provisions of section 90 of the Act No. 38 of 2000 and section 95 of the Act No. 10 of 2006 of the Inland Revenue Act and to remit the same to the department of Inland Revenue; and

(b) the Appellant failed to comply

Without any evidence at all and when no such request was ever made?

Yes the Commission erred in Law.

(ii) Did the Commission err in law in arriving at the conclusion of fact that it appears obvious that the crediting of the sum was done in Sri Lanka, without any evidence at all?

The fact that the crediting took place in Sri Lanka has to be proved as a question of fact. This was not proved and accordingly the Commission erred in law.

(iii) Did the Commission err in law when it arrived at the conclusion of fact that the credit manager of the Appellant company admittedly credited the

ship rents to the vessel owners, without any evidence, and when there was no admission by or on behalf of the Appellant that a credit manager, whom the company never had in Sri Lanka credited the ship rents to the vessel owners?

Yes the Commission erred in law

(iv) Having recognized the term "rent" is a matter for determination, did the Commission err in law in its failure to determine the term "rent"?

What was payable to the ship owners was rent and this has to be answered in favor of the Respondent.

(v) Having correctly concluded that the Appellant company cannot be considered as a company in Sri Lanka, did the Commission err in law in substituting *a person operating in Sri Lanka for a person in Sri Lanka* referred to in section 90/95?

Yes

(vi) Did the Commission err in law when it confirmed the penalties as computed in the two assessments for the reason that the taxes are in default, and in disregard of submissions of the authorized representative for the Appellant and contrary to the provisions in section 144 and173?

Yes

(vii) Having regard to the interpretation of section 44 of the Income Tax Ordinance No. 2 of 1932 which corresponds to section 90/95, as found in the Ceylon Income Tax manual of Commissioner of Income Tax, is the Appellant company a person in Sri Lanka for the purposes of section

90/95?

No

(viii) Are the amounts credited/paid in Denmark by the Appellant company to the ship owners "rents" within the meaning of the term in section 90/95?

Yes

(ix) Is the Appellant liable in terms of section 90 and 95 to deduct withholding tax at 20% from the amount it credited/paid in Denmark to the ship owners?

No

(x) Did the Commission fail to properly examine and/or apply and/or appreciate the facts and the law relevant to this matter?

Yes

PRESIDENT OF THE COURT OF APPEAL

Sobhitha Rajakaruna, J

I agree.

JUDGE OF THE COURT OF APPEAL