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

In the matter of a Case Stated for the opinion of the Hon. Court of Appeal under Section 170(1) of the Inland Revenue Act No.10 of 2006 read with Section 45(1) of Inland Revenue (Amendment) Act, No: 22 of 2011.

Ceyspence (Pvt.) Ltd. (under Liquidation)
No: 1, Alfred House Avenue,
Colombo 03.

CA/TAX/5/2013
Tax Appeals Commission
Appeal No:TAC/(IT)/012/2011

Appellant

Vs.

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

Respondent

BEFORE : K.T. CHITRASIRI, J. &
L.T.B. DEHIDENIYA, J.

COUNSEL : Shibly Aziz PC with Dushantha De Silva, Anita Perera & Anslem Kaluarachchi for the Appellant.
Suranga Wimalasena SSC for the Respondent.

ARGUED ON : 02.04.2015
WRITTEN SUBMISSIONS TENDERED ON : 24.06.2015 & 26.06.2015
DECIDED ON : 24.07.2015

L.T.B. DEHIDENIYA, J.

This is a case stated by the Tax Appeal Commission (TAC), instigated by the assesee (the Appellant), for the opinion of this Court on several questions of law. The Appellant is a company incorporated in Sri Lanka under the Companies Act. The appellant has entered in to an agreement with the Board of Investments (BOI) to setup/conduct and operate international sea cargo business. Under the said agreement the BOI has granted several benefits to the appellant, among which a tax exemption for a limited period was significant. The appellant, sometime after the commencement of the business, disposed its only asset, the ship and the bunker fuel, during the assessment year of 2007/2008. The appellant claimed tax benefit for the sale proceeds of its asset stating that it comes within the scope of his business, was rejected by the assessor and served an assessment. The appellant appealed against this assessment to the Commissioner General of Income Tax, who affirmed the said assessment. Thereafter, appealed to the TAC. They also affirmed the determination of the Commissioner. Being aggrieved by the said decision of the TAC, the appellant requested the TAC to submit a case stated to this Court for the opinion of the Court.

The TAC has formulated the following questions of law for the opinion of this Court.

1. Having regard to the Clause 13 (1) of the agreement No. 170 between the Appellant and the Board of Investment of Sri Lanka (hereinafter the 'BOI Agreement') read with section 17 (1) of the Board of Investment of Sri Lanka Law No. 4 of 1978, Regulation No. 2 in Gazette Extraordinary No. 8/2 dated 31 October 1978 made by the Minister in charge of the subject of finance under the said BOI Law and section 106(2) of the Inland Revenue Act No. 10 of 2006, was the appellant company Messrs. Ceyspence (Pvt.) Ltd. a person chargeable to income tax under the provisions of the Inland Revenue Act No. 10 of 2006.

2. Did the Commission err in Law by its failure to consider the effect of Section 17 of the Board of Investment of Sri Lanka Law No. 4 of 1978 and the Regulations numbered 2 and 6 of the BOI Regulations published in the Gazette Extraordinary No.8/2 dated 31 October 1978, which represent the relevant empowering provisions, in the interpretation of Clause 13 of the BOI Agreement.

3. Did the Commission err in law in holding that the appellant company was chargeable to income tax under the provisions of the Inland Revenue Act, No. 10 of 2006 on the profit which arose to the appellant during the year of assessment 2007/2008 on the sale of the ship owned by the appellant.

4. Did the Commission err in Law in holding that the profit which arose to the appellant during the year of assessment 2007/2008 on the sale of the ship owned by the appellant is chargeable with income tax, without indicating the provisions of the Inland Revenue Act, No. 10 of 2006 in terms of which such profit would be liable to tax.

5. Did the Commission err in Law in its failure to consider that the assessment under appeal in erroneous and contrary to the Law in that the said assessment was made by the Assessor by applying sections of the Inland Revenue Act, No. 10 of 2006 which are not applicable to the circumstances pertaining to the appellant.

6. Did the Commission err in Law in its failure to consider the effect of section 106 (1) and (2) of the Inland Revenue Act, No. 10 of 2006, which was relied upon by the Authorized Representative of the appellant in his submissions made to the Commission on behalf of the Appellant.

7. Did the Commission err in Law by misdirecting itself and/or reaching a finding which was unreasonable and/or unsupported by the evidence or material placed before it and/or due to a misconception of the law, in arriving at the following conclusions reached by it, namely

   a) That the BOI Agreement may not be 'strictly applicable' where the Company is in the process of liquidation (Whereas the ship was sold prior to the steps been taken for liquidation).

   b) That the sale of the ship and the stock of bunker fuel is not related to the business activity permitted under the Agreement where the tax exemption has been granted.

c) (i) The procedure provided for in the Agreement to obtain the approval of the BOI before the sale of any items has not been complied with in relation to the sale of the ship.

(ii) that the conclusion reached by the Commission set out in (i) above has been 'confirmed; by the letter No. EC/16/17/3085/05 dated 10.09.2009 (whereas the letter does not in any manner whatsoever attempt to do so)

d) That the fact that the BOI has not issued the tax exemption certificate for the year 2007/2008 supports the contention that the profits and income from the disposal of the ship and the stock of bunker fuel are liable for income tax (whereas the letter dated 10.09.2009 from the BOI referred to in (d) above confirms that the Appellant company was entitled to the exemption during the period 15th March 2005 to 14th December 2007).

As I have pointed out earlier, all these questions are revolving around one issue, i.e. whether the sale proceeds of the asset of the company can be exempted from the income tax.

The appellant entered in to an agreement with the BOI No. 170 dated 17.02.2005 attested by the Notary Public Peter Wickremasinghe, (Annex 1). The clause 13 of the agreement specify the tax benefits granted to the appellant. The clause 13 reads thus;

In accordance with and subject to the powers conferred on the Board under Section 17 of the said Law No. 4 of 1978 and Regulations that may be applicable thereto the following benefits and/or exemptions and/or privileges are hereby granted to the enterprise in connection with and/or in relation to the business.

i) For a period of 5 years reckoned from the year of assessment may be determined by the Board (hereinafter referred to as the 'tax exemption period') The provisions of the Inland Revenue Act No. 38 of 2000 relating to the imposition, payment and recovery of income tax in respect of the profits and income of the enterprise shall not apply to the profits and income of the enterprise.

Under this agreement, the enterprise is the appellant. As per the agreement, the tax benefit is 'granted to the enterprise', with a qualification that it is "granted to the enterprise in connection with and/or in relation to the business". Therefore, the opening part of the clause 13 of the agreement grants the benefits and/or exemptions and/or privileges to the enterprise only in connection with and/or in relation to the business. It doesn't say that those privileges, exemptions and benefits are granted to the enterprises irrespective of the business that they are engaged in. Therefore, the appellants' entitlement for tax benefit under the agreement No. 170 is limited for the business in connection with or in relation to the business that has been agreed upon in the said agreement.

As per agreement No. 170, the appellants' request to the BOI was to set up/conduct and operate a business to provide international sea cargo service. This application has been approved by the BOI and the parties entered into the said agreement No.170 where the appellant was granted certain entitlements subject to the provisions of BOI Law and the Regulations made thereunder and subject to the terms and conditions of the agreement. The first entitlement granted to the appellant is to setup/conduct and operate the business in accordance with the undertakings, representations, commitments and proposals made by the enterprises and set out in the application and as set out in the agreement and all correspondence therewith including those enumerated in the schedule to the agreement, subject to the BOI Law and Rules and Statutory Regulations. Apart from the agreement, other communications were not brought to the notice of the Court. Therefore, this Court has to consider what is contained in the agreement only. As per the agreement, the business that the appellant agreed upon is international sea cargo service business.

Under Clause 13 (1) agreement, a tax exemption period has been granted to the appellant in connection with and/or in relation to the business. The operative words in the opening parts of this Clause is 'in connection with and/or in relation to'. The Regulations made under the BOI Law and published in the Gazette Extraordinary No. 8/2 dated 31.10.1978. Rule 2 (i) says that a tax exemption period can be granted in relation to the enterprise. The Rule 6 of the said gazette says that the exemptions and the modifications of the Law set out in the Regulations may be granted to an enterprise only in respect of or in relation to a business carried on by the enterprise under and in terms of the agreement entered into under Section 17 of the Greater Colombo Economic Commission Law (now Board of Investment Law) No. 4 of 1978. Any other business other than the business

specified in the agreement will not be entitled for tax exemptions. Therefore, to be qualified for the tax exemption it has to be a business connected with or in relation to the agreed business. In fact, learned Counsel for the appellant admits that only an activity in connection with and/or in relation to the business is qualified for tax exemption (paragraph 77 of the written submissions of the appellant dated 26.06.2015).

Under these circumstances, my opinion on the first question formulated by the TAC is that under the provisions of the Inland Revenue Act No. 10 of 2006, the appellant company is a person chargeable to income tax on any business other than the business in connection with or in relation to the business specified in the agreement No. 170.

The ship sale and the sale of bunker fuel is the transaction that has been considered as a taxable business by the Assessor. The main issue in this case is whether this transaction or business is a part of the same business of setup/conduct and operate international sea cargo service business or not. It is an admitted fact that the appellant has agreed with the BOI to setup/conduct and poerate international sea cargo service business. The ship is the equipment used for the operation of the said business. It is like having an on shore site office. The agreement says that the company is having an on shore office at the given address. The equipment like computers, tables, chairs etc., in the office are also used for the operation of the business. The disposal of these equipment, or the office itself, cannot be considered as a business connected with or in relation to sea cargo service. The ship and its fuel is also same, it is an equipment utilized for the conduct of the sea cargo service. Just because the ship is in off shore and the office is in on shore, there cannot be any difference.

The learned Counsel for the appellant cited several authorities in support of his contention. The preamble of the agreement No. 170 refers to business of the appellant. In the judgment of the High Court of Punjab and Haryana in the case of *Aradhana Drinks and Beverages (Pvt.) Ltd vs. State of Punjab* (2011) (3) L.A.R. 69, it has been held that *"the 'business' is a very spacious expression and in fiscal authorities it must be construed in broad rather than restricted sense to include anything which occupies the time, attention and labour of a man for the purpose of profit"*. In the case before us the issue is whether the sale of the only asset of the company is a business connected and/or in relation to the sea cargo service.

Doypack Systems Pvt. Ltd. Etc. vs. Union of India and Ors., etc. 1988 A.I.R. 782 is a case on an issue whether the shares held in two subsidiary companies by a textile company is vested in the government or not under an acquisition. In that case Indian Supreme Court interpreted the Swadeshi Cotton Mills Company Limited (Acquisition and Transfer of Undertaking) Act 1988. In reference to the said act Court held that *the expression "in relation to" has been interpreted to be the words of widest amplitude. The Court held that Section 4 of the said Act uses the words "ownership, possession, power or control of the company in relation to the said undertaking".* The Indian Supreme Court interpreted the expression "in relation to" in a different context than it is used in the case before us. In the present case, the words "in relation to" is used in reference to a specific business where the parties have agreed upon, not in reference to the assets earned from the business. The ship is an asset not even bought from the earnings of the appellants' sea cargo service business but an initial capital investment.

The issue in the case of *National Textile Corporation vs. Seetharam Mills Limited* 1986 A.I.R. 1234 is the meaning of assets in relation to the textile undertaking. In the case before us there is no dispute to the fact that the ship is an asset of the appellant.

In the case of *The Commissioner Central Exercise vs. M/S. Ultratech Cement Limited* (2010) (10) TMI 13, the employer has provided outdoor catering service for the employees and the Court has held that it is in relation to the manufacture of cement. Court held that it is an input in relation to the manufacture of cement. In that case also the Court examined the word input in a different context. Things in relation to the manufacture of cement is totally different from disposing the only asset. The ship, the only asset of the appellant, was the equipment utilized for the sea cargo service. The tax exemption is granted to the business in relation to or in connection with international sea cargo service business. All the authorities cited by the learned Counsel for the appellant does not throw any light on the issue of disposing assets.

My view is that it is not necessary to go in to Indian authorities. The legislature has expressed its intention clearly in the Inland Revenue Act No. 10 of 2006. The section 25 (3) of the Act defines that the disposal of assets is a separate business and the legislature has brought the profits made out of that in the profit of the business. The section reads thus;

(3)(a) Where any person disposes of any capital asset used by him in producing the profits and income of any trade, business, profession or vocation and a total amount equal to the cost of acquisition or the cost of construction, as the case may be, of such capital asset has been granted as allowance for depreciation of such capital asset, the full amount of the proceeds of such disposal, whether such disposal takes place while such trade, business, profession or vocation continues or on or after its cessation, shall be treated as a receipt of such trade, business, profession or vocation in ascertaining the profits and income within the meaning of paragraph (a) of section 3.

(b) Where any person disposes of any capital asset used by him in producing the profits and income of any trade, business, profession or vocation carried on or exercised by him and an allowance for depreciation has been granted in respect of that capital asset but the total amount of such allowance is less than the cost of acquisition or the cost of construction, as the case may be, of such capital asset, the excess of the proceeds of such disposal over the difference between the cost of acquisition or the cost of construction of such capital asset, and the total allowance for depreciation granted in respect of such capital asset, shall, whether such disposal takes place while such trade, business, profession or vocation continues or after its cessation, be treated as a receipt of such trade, business, profession or vocation, in ascertaining the profits and income of such trade, business, profession or vocation, within the meaning of paragraph (a) of section 3 :

Provided that.........

If the legislature has intended that the sale of assets is a part of the line of the business that the person engaged in, it is not necessary to enact section 25 (3) to bring in the loss or profit in sale of asset in to the business. Therefore the legislature has clearly expressed its intention that the sale of assets is not a part of the same business. This is further strengthened by sub section (c) the section 25 (3), which reads thus;

(c) Where a person carrying on any undertaking, the profit and income of which are wholly or partly exempt from income tax under this Act, disposes of any capital asset used for the purposes of that undertaking, such person shall be liable to

income tax on an amount equal to the amount ascertained under paragraph (a) or paragraph (b).

The sale of asset by a person chargeable with tax is different from a person granted with a tax holiday.

The learned counsel for the appellant submitted section 25 (3)(b) and argued that there cannot be any inconsistency. His argument is that if the Respondent treats the proceeds of the sale of the asset as receipt of such business, in ascertaining the profit and the income of such business, then the Respondent has to concede that the said proceeds of the sale are in fact part of the profits and the income of the business of the appellant enterprise, which qualify for the tax exemption. I do not agree with this argument. Sub section (c) clearly differentiate a person chargeable with income tax and a person having a tax holiday. The appellant is a person having a tax holiday. Therefore sub section (c) applies to the appellant. The profits earned from disposal of asset is taxable.

The utilization of the assets of a company and earning profit is different from disposing the only asset of the company.

My opinion on question No. 2 to 6 is that the Commission did not err in Law in making their determination.

The appellant strenuously argued that the appellant was not in the process of liquidation when it disposed the ship. The TAC has come to a finding that the appellant was in the process of liquidation and therefore the BOI agreement is not applicable. This was not the main finding of the Commission. As a passing remark, the Commission has stated that the appellant was in the process of liquidation. It is obvious when the appellant disposed its only asset, the ship, used for the sea cargo service, the appellant has to cease the business or go for liquidation. In any case in the following year appellant company was liquidated.

As I have pointed out earlier the Tax Appeal Commissions' determination was not based on the liquidation of the appellant. Therefore, my view is that the question No. 7 (a) does not arise from the opinion of the Court. Question No 7 (c) (i) and (ii) also do not arise

because the determination of the TAC is not based on that. I have already expressed my opinion on question No. 7 (b).

The BOI has granted a tax benefit to the appellant under the agreement No.170. The appellant has ceased function from the date of the sale of the ship. The appellant cannot engage in the international sea cargo service any more. Under this circumstances appellant is entitle for the tax benefit for the business of international sea cargo service until the sale of the ship, which has been allowed by the respondent. Therefore the question No. 7(d) does not arise.

I direct the Registrar of this Court to return the record to the Tax Appeal Commission with the opinion of this Court.

Judge of the Court of Appeal

K.T.Chitrasiri J.

I agree.

Judge of the Court of Appeal