IN THE COURT OF APPEAL

OF THE DEMOCRATIC SOCIALIST REPUBLIC OF SRI LANKA

Ceylon Steel Corporation Limited
[Formerly known as Ceylon Heavy
Industries & Construction Co. Ltd]
Oruwala, Athurugiriya.

Appellant

NO.C.A/TAX/10/2010
&
NO.CA/TAX/18/2013

Vs

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

Respondent

BEFORE : **K.T.CHITRASIRI, J**

L.T.B.DEHIDENIYA, J

COUNSEL : Shivaji Felix for the Petitioner

Anusha Samaraayake SSC with Chaya Sri Nammuni SC for the Respondent

ARGUED ON : 09.06.2015

WRITTEN SUBMISSIONS FILED ON : 04.06.2015 by the Petitioner

04.06.2015 by the Respondents

DECIDED ON : **06.08.2015**

CHITRASIRI, J.

These two cases which bear the Nos.CA/TAX/10/2010 and CA/TAX/18/2013 have been transmitted to this Court in terms of Section 170 of the Inland Revenue Act No.10 of 2006 seeking for an opinion to the questions of law mentioned in the "case stated" formulated by the Board of Review and the Tax Appeals Commission respectively. The case bearing No.CA/TAX/10/2010 had been sent by the Board of Review that was in existence then whilst the case bearing No.CA/TAX/18/2013 had been sent by the Tax Appeals Commission established under the Tax Appeals Commission Act No.23 of 2011.

Both matters were heard together since the parties, the legal issues and the questions of law involved in the two matters are identical. It was decided so, on the request and with the consent of the parties. Accordingly, with the view of forming an opinion, in terms of Section 170(6) of the Act No.10 of 2006, this Court considered the questions of law raised in the "case stated". The questions of law to which the opinion was sought are as follows:

(i) Has the Board of Review/Tax Appeals Commission erred in law by coming to the conclusion that the appellant was not entitled to a tax exemption under and in terms of its agreement with the Board of Investment of Sri Lanka in respect of its profits of the sale of imported steel wire?

(ii) Has the Board of Review/Tax Appeals Commission erred in law in coming to the conclusion that the Board of Investment of Sri Lanka does not possess the power to review the scope and the terms and conditions of agreements entered into by it?

(iii) In view of the facts and circumstances of the case, is the decision of the Board of Review/Tax Appeals Commission regarding the tax exempt status of the appellant against the weight of evidence?

The first question of law relates to income tax exemption granted to the appellant company under the Agreement bearing No.72 dated 07.05.1998, attested by C.M. Jayawardena Notary Public. The said exemption referred to in Clause 10(1) in the aforesaid agreement reads thus:

10. 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 said business.***

(1) For a period of ten (10) years reckoned from the year of Assessment as may be determined by the Board (hereinafter referred to as "the said tax exemption period") the provisions of the Inland Revenue Act No.28 of 1979 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.

(2)...

(emphasis added)

The Board of Investment has exercised its powers conferred on it under Section 17 of the Board of Investment Law of Sri Lanka No. 4 of 1978 as amended and afforded the appellant company, the tax exemptions referred to above. Accordingly, it had executed the said agreement bearing No.72, making the appellant company a party. Hence, it is seen that the appellant company had been exempted from payment of income tax in respect of the profits and income derived by it from its commercial activities that has connection with and/or in relation to the business of the company.

Learned Counsel for the appellant having relied upon the aforesaid phrase ***"benefits and/or exemptions and/or privileges are hereby granted to the Enterprise in connection with and/or in relation to the said business",*** strenuously submitted that importation and sale of steel wire which is commonly known as "stirrups" has connection and/or it relates to the main business of the appellant company. It is to be noted that the main business of the appellant company was manufacturing of rolled wire and founding steel products. Accordingly, learned Counsel for the appellant contended that that the appellant company is entitled to claim tax exemption under clause 10(1) of the aforesaid agreement bearing No.72.

In support of his contention, learned Counsel for the appellant has heavily relied upon an opinion expressed by Professor W.P.S. Dias who is a Senior Professor in Steel Engineering and a Chartered Structural Engineer of the Department of Civil Engineering in the University of Moratuwa. The said opinion expressed by Prof.Dias in his letter dated 05.02.2009 is as follows:

> *"The tor steel manufactured by this company is used widely in the construction industry. The company also supplies 6 mm steel wire to the construction industry. The 6 mm steel wire is used as stirrups or links in order to form a "cage" of reinforcement together with the tor steel bars. As such, given that most consultants specify 6 mm steel for these links and stirrups, and since such 6 mm steel is the most widely used form of links or stirrups, the construction industry would not be able to use for steel bars without the 6 mm steel."*

Certainly, opinion as to the link between manufacture of rolled wire and steel products with that of steel wire known as stirrups, of such an expert cannot be disregarded. However, it is important to note that there had been a specific background for the BOI to grant such a tax exemption to the appellant company. Consideration to afford the tax exemption by the BOI was kicked off, upon a request made by the appellant company by its letters dated 15.11.1996 and 01.04.1998. Request made in those two letters were **to seek approval to modernize and upgrade the company's existing factory at Athurugiriya.**

Therefore, the exemptions that were sought by the appellant could be applied only to the matters connected with modernizing and upgrading the factory at Athurugiriya of the appellant company. This position is clearly seen even in the recital to the aforesaid Agreement bearing No. 72. The said recital reads thus:

> *"WHEREAS the Enterprise which is presently carrying on the business of manufacture of rolled wire and founding, steel products at its factory at Athurugiriya made an application on 15th November, 1996 and subsequent letter dated 1st April 1998* ***seeking approval to modernize and upgrade the existing factory at Athurugiriya (hereinafter referred to as "the said business") on the land and premises at Athurugiriya*** *morefully described in the First Schedule hereto (hereinafter referred to as "the said land and premises") and situated outside the Area of Authority of the Board."*
>
> *(emphasis added)*

Needless to say that import and sale of stirrups will have no bearing to modernize and upgrade the appellant's factory at Athurugiriya. Admittedly, the appellant company has made profits by importing and selling stirrups even though such an activity does not relate to modernize and upgrade the existing factory at Athurugiriya. Therefore, I must clearly mention that the tax exemptions referred to in clause 10(1) in the agreement 72 is applicable and also is restricted to the claims that do come within the purpose for which the very

same agreement was executed. It is more so when looking at the matters that led to grant such an exemption to the appellant company.

Therefore, it is my considered view that the import and sale of stirrups by the appellant does not cover the purpose for which the agreement 72 was entered into. Accordingly, it is seen that the appellant company is not entitled to claim tax benefits for sale of stirrups under the agreement though the ordinary meaning may lead to show that it has connection between stirrups and manufacturing of rolled wire and founding steel products. Hence, it is clear that the exemptions referred to in the Agreement bearing No.72 does not extent to import and sale of stirrups since it has no bearing to the very purpose of entering into the Agreement bearing No72. In the circumstances, it is my opinion that the exemption Clause 10 (1) in the Agreement bearing No.72 will not apply when determining tax liability of the appellant for the income derived from import and sale of stirrups.

Learned Counsel for the appellant has referred to many authorities including that of **In Re Nanaimo Community Hotel Ltd [1994] 4 DLR 638 (cited approvingly in Emery V Inland Revenue Commissioners [1981] STC 150 at page 171** and **V.A.Vasumathi V CIT [1980] 123 ITR 94 (KER)** to show the connection between the stirrups and manufacture of rolled wire. In, **In Re Nanaimo (supra) McFarlane J in the Supreme Court of British Columbia** stated as follows:

" One of the very generally accepted meanings of "connexion" is "relation between things one of which is bound up with or involved in another"; or again, "having to do with". The words include matters occurring prior to as well as subsequent to or consequent upon so long as they are related to the principal thing. The phrase "having to do with" perhaps gives as good a suggestion of the meaning as could be had."

In the case of **Vasumathi** (supra) it was held that the words "in connection with such transfer" means intrinsically related to the transfer. All those authorities explain the connection between the stirrups and manufacture of rolled wire. However, as mentioned hereinbefore, it is not possible to rely on such an interpretation in this instance since the tax benefit claimed by the appellant company can be determined only by looking at the purpose to which the Agreement was entered into and also upon considering the totality of the Agreement bearing No.72.

At this stage, it is also pertinent to note that sub clause (V11) of Clause (10) in the Agreement bearing No.72 refers to an exemption from custom duty as well. It has granted tax exemption for the appellant company for its imports only for a period of 3 years. Therefore, it is seen that the exemptions referred to in the Agreement bearing No.72 contains special provisions when it comes to the import duty exemptions. The claim in this instance too involves imports. Therefore, any claim that has connection to importation of goods by the appellant shall govern by

the said clause 10 (V11). Accordingly, it is my opinion that the Clause 10(1) in the Agreement bearing No.72 does not permit the appellant to claim income tax exemption for the import of stirrups.

Hence, it is seen that the tax exemptions for the income and profits from sale of stirrups cannot be claimed under clause 10(1) of the agreement 72. For the reasons set out hereinbefore, I answer the first question of law in favour of the respondent.

The next question is whether the Board of Investment of Sri Lanka did possess the power to review scope and the terms and conditions of the Agreement bearing No.72. In this instant, the Board of Investment of Sri Lanka by letter dated 09.04.1998 has approved the tax concession requested by the appellant company. The Board of Review/Tax Appeals Commission was of the view that the Board of Investment had no power to review the scope and the terms and conditions of the said Agreement. The said letter of the BOI is as follows:

> *"According to your submissions on the above matter, the wire rods are a necessary component for the sale of steel products manufactured by CHICO.*
>
> *Therefore, sale of wire rods will qualify for tax exemption under Sec.10 of the said agreement.*
>
> *Yours faithfully,*

Sgd/.....

A.M.C.Kulasekera

Deputy Director General (Investment)

Board of Investment of Sri Lanka"

Admittedly, the decision referred to in that letter had been made upon considering only the submissions made by the appellant company. Respondent did not have the opportunity to counter those submissions. Therefore, even if the contents in the said letter are taken into consideration, such an opinion that was formed without hearing the interested parties may not reflect the correct interpretation of the Agreement No.72.

More importantly, it is the Commissioner General of Inland Revenue that has the power and authority to implement the provisions of the Inland Revenue Act. He is not bound by the opinions expressed by the Board of Investment of Sri Lanka when it comes to determining tax liability under the law. Therefore, it is not incorrect to decide that the Board of Investment does not possess the power to review the scope and the terms and conditions of the Agreement bearing No.72. Hence, the answer to the question No.2 also is in favour of the respondent.

The remaining question is to consider whether the decision of the Board of Review/Tax Appeals Commission was against the weight of the

evidence. The aforementioned discussion in relation to the first two questions of law mentioned in the "case stated" speak to itself that the Board of Review/Tax Appeals Commission has carefully considered the terms and conditions of the Agreement bearing No.72.

Such a view will become more strengthen when looking at the reasons assigned by the members of the Board of Review and the Tax Appeals Commission in their respective determinations. The Board of Review in its determination made on 05.02.2010 has stated as follows:-

"Now we are of the view that the imported steel wire did not have the necessary nexus with the manufacture of rolled wire and founding steel products. Commercial definition of manufacture is to process or make (a product) from a raw material especially as a large scale operation using machinery. The agreement covered the incentives granted/available to the enterprise for the additional investment made for the modernization and upgrading of the factory at Athurugiriya. These tax incentives are available for the investment made (i.e. upgrading and modernization of factory at Athurugiriya). Therefore the above submission of the appellant has no merit as the imported steel wire is not used in the factory for commercial production purposes. In connection with and/or in relation to the said business should read as in connection with and/or in relation to manufacture of steel in the factory at Athurugiriya."

Tax Appeals Commission in its determination has mentioned thus:

> *"The Respondent contends that for the company to import steel wire for sale implies that the company has not engaged in the manufacture of this kind of wire in its factory at Athurugiriya. The steel wire was not imported for use in the process of manufacture of the tor steel bars or in the modernization and upgrading of the factory, but imported to enhance the sale of tor steel bars manufactured by the company, and, therefore, is an activity falling outside the scope of the Agreement. Tax exemption is granted by the Agreement only for the investment made for modernizing and upgrading the business of manufacture of rolled wire and founding steel products. The import and sale of steel wire is, therefore, not an activity which would attract exemption from income tax on the profits and income derived from such sale. The Appellant had claimed tax exemption in respect of the entire business income of Rs.638,857,939/- by virtue of Clause 10 of Agreement with the BOI. However, the Assessor who examined the audited accounts of the company identified that this sum included income from the sale of imported steel wire which was liable to tax and the assessment was issued accordingly. The Assessor issued the assessment on the ground that profit attributable to the sale of imported steel wire was estimated to be Rs.28,791,117/-. However, according to the submissions made by the Respondent, it was later agreed between the parties that the net profit derived from the sale of imported steel wire was, only Rs.11,045,613/-."*

Upon considering the matters contained in the two preceding paragraphs, it is clear that the Board of Review as well as the Tax Appeals Commission in their determinations have carefully looked at the evidence before them when they arrived at their respective decisions. Therefore, I am of the opinion that the decisions of those two institutions on the question of income tax exemption referred to in the Agreement bearing No.72 show that the members of the respective institutions have considered and evaluated the relevant evidence placed before them, carefully when arriving at their respective decisions.

As mentioned before in this judgment, this Court is of the opinion that all three questions of law referred to in the "Case Stated" should be answered in the negative. Accordingly, the Registrar of this Court is directed to return the records maintained before the relevant tribunals along with the opinion of this Court expressed hereinbefore, to the Tax Appeals Commission.

JUDGE OF THE COURT OF APPEAL

L.T.B.DEHIDENIYA, J

I agree

JUDGE OF THE COURT OF APPEAL