

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 Court of Appeal;*

*in terms of section 122 of the Inland
Revenue Act, No. 28 of 1979 as
amended¹*

and

*in terms of section 11 A of the Tax
Appeals Commission Act No. 23 of 2011
as amended by Act No. 20 of 2013².*

CA (Tax) Appeal No. 01/ 2011

C A (Tax) Appeal No. 21 / 2013

Ceylon Petroleum Corporation

¹ CA (Tax) Appeal No. 01/ 2011

² C A (Tax) Appeal No. 21 / 2013

Rotunda Tower,
109,
Galle Road,
Colombo 03.

APPELLANT

-Vs-

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

RESPONDENT

Before: A H M D Nawaz J

P Padman Surasena J

Counsel: Dr. Shivaji Felix for the Appellant.

Arjuna Obeysekera SDSG for the Respondent in CA (Tax)

Appeal No. 01/2011

Priyantha Nawana SDSG for the Respondent in CA (Tax) Appeal

No. 21/2013

Argued on : 2017 - 01 - 30

2017 - 01 - 31

Decided on: 2017 - 08 - 08

JUDGMENT

P Padman Surasena J

When the above numbered cases namely, C A (Tax) Appeal No. 01/ 2011 and C A (Tax) Appeal No. 21/ 2013 were taken up for argument on 2017-01-30, learned counsel for both parties agreed that the issues to be decided by this court in respect of both these cases are the same.

Learned counsel for both parties hence agreed that it would suffice for this Court to pronounce one judgment in respect of both the above cases. Therefore this judgment must apply to both the cases above referred to.

The Appellant is a state enterprise established by Act No. 28 of 1961 engaged in importing, refining, selling, and distributing petroleum products in Sri Lanka.

The dispute arose when the Respondent rejected the Appellant's claim that the deemed dividend tax has to be calculated on the taxable profit of the corporation during the respective years of assessments and that the appellant corporation did not attract such tax liability as it did not return any taxable income for the said respective years.

The Respondent having rejected the Appellant's tax return on that basis had issued a fresh assessment.

In C A (Tax) Appeal No. 01/ 2011, the Appellant being dissatisfied with the fresh assessment had submitted an appeal against the said assessment to the Commissioner General of Inland Revenue (hereinafter sometimes referred to as the Commissioner General). The Commissioner General referred the said appeal to the Board of Review. The Board of Review

having heard the submissions of parties confirmed the assessment and dismissed the said appeal of the Appellant. Being dissatisfied with the decision of the Board of Review the Appellant had made an application to state a case for the opinion of the Court of Appeal which is the instant appeal.

In C A (Tax) Appeal No. 21/ 2013 the Appellant being dissatisfied with the refusal of his claim by the assessor, appealed to the Commissioner General of Inland Revenue. The Commissioner General in the determination made on 2011-10-21, confirmed the assessment of the Assessor. Being dissatisfied with the said determination, the Appellant appealed to the Tax Appeals Commission. The Tax Appeals Commission having heard the submissions of parties confirmed the assessment and dismissed the appeal of the Appellant. The Appellant, being dissatisfied with the decision of the Tax Appeals Commission, took steps to have a case stated for the opinion of the Court of Appeal which is the other instant appeal.

In C A (Tax) Appeal No. 01/ 2011, the two questions of law that have been formulated for the opinion of this Court by the Board of Review is as follows.

Question No. 1

"Did the Board of Review err in law when it interpreted section 33(1) (c) of the Inland Revenue Act No. 28 of 1979 (as amended) to mean that it was not the taxable income but the book profits that were to be taken into consideration when computing income tax liability under the aforesaid section ? "

Question No. 2

"In view of the facts and circumstances of the case did the Board of Review err in law by coming to the conclusion that it did ?"

In C A (Tax) Appeal No. 21/ 2013, the two questions of law that have been formulated for the opinion of this Court by the Tax Appeals Commission is as follows.

Question No. 1

"Did the Tax Appeals Commission err in law when it came to the conclusion that the profits for the computation of deemed dividend tax, as contemplated by section 61 (1) (c) of the Inland Revenue Act No. 10 of 2006 (as amended) should be book profits ?"

Question No. 2

"In view of the facts and circumstances of the case did the Tax Appeals Commission err in law when it came to the conclusion that it did?"

It must be mentioned here that the wording appear in both section 33(1) (c) of Inland Revenue Act No. 28 of 1979 as amended and section 61(1) (c) of Inland Revenue Act No. 10 of 2006 as amended are similar. As the parties have based their submissions, and the subsequent written submissions filed, on section 33(1) (c) of the Inland Revenue Act No. 28 of 1979, it would be prudent to commence the exercise of considering the above questions of law by reproducing the relevant parts of **section 33 (1)** of the Inland Revenue Act, No 28 of 1979 (as amended). (This Act³ would hereinafter be referred to as the Act in this judgment). It is the contents of this section and similar content in section 61 (1) (c)⁴ that this Court is called upon to interpret in the instant cases.

Section 33 (1) of the Inland Revenue Act, No 28 of 1979 (as amended)

³ Inland Revenue Act, No 28 of 1979

⁴ Inland Revenue Act No. 10 of 2006

".... The income tax to which any company resident in Sri Lanka in any year of assessment shall be liable for that year of assessment shall consist of -

- a) an amount calculated on the taxable income of such company for that year of assessment at the appropriate rate specified in the Second Schedule to this Act as the rate applicable to companies of that class; and
- b)
- c) in the case of any public corporation not less than seventy five per centum of the capital of which is provided by the Government, other than by way of a loan, for any year of assessment commencing on or after April 1, 1986 (hereinafter referred to as "the relevant year of assessment"), an amount equal to twenty five per centum of the balance of its profits for that year of assessment after deducting therefrom the tax payable for that year of assessment under paragraph (a):

Provided that where the aggregate amount of any gross dividends distributed in the relevant year of assessment out of the profits on which

the taxable income of such corporation is computed for any year of assessment commencing on or after April 1, 1986 –

- i. is not less than twenty five per centum of such balance, the provisions of this paragraph shall not apply; and
- ii. is less than twenty five per centum of such balance, the tax to which such public corporation is liable under this paragraph, for the relevant year of assessment, shall be an amount equal to the excess of twenty five per centum of such balance over such amount of such dividends.

For the purposes of this paragraph, the profits of the Insurance Corporation of Sri Lanka shall be deemed not to include its profits from the business of life insurance; and ”

As the task of this Court in this case involves interpreting some provisions of taxing statutes, it would be prudent to bear in mind the applicability of some of the basic principles that may become relevant when this Court undertakes the task of interpreting such provisions in this case.

These principles are;

- i. that a person can be charged with tax not by inference or analogy, but only by the plain words of the provisions in the taxing statutes.
- ii. that no tax can be imposed on any person unless there are clear words in the statute which should show a clear intention on the part of the legislature to impose liability to income tax on a person.
- iii. that principles of equity should not be applied when interpreting such provisions.
- iv. that once a liability to income tax is found, the subject cannot escape taxation unless he can find a clear exempting section.

The above principles make it clear that Courts can neither presume nor imply any intendment as to tax. It must only look carefully at the section of the statute. This must be so in view of the fact that the subject is entitled to arrange his affairs so as to reduce his liability to tax.

In Cape Brandy Syndicate V Inland Revenue Commissioners⁵ Rowlatt J stated as follows; "... It is urged by Sir William Finlay that in a taxing Act clear words are necessary in order to tax the subject. Too wide and fanciful a construction is often sought to be given to that maxim, which does not mean that words are to be unduly restricted against the Crown, or that

⁵ 1921 (1) K B 64 at page 71

there is to be any discrimination against the Crown in those Acts. It simply means that in a taxing Act one has to look merely 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. Nothing is to be read in, nothing is to be implied. One can only look fairly at the language used. ...”

The case of Trust Union Shipping Corporation V Commissioner General of Inland Revenue⁶ is an instance where this Court had adopted the above principles referring to the said Cape Brandy Syndicate⁷ case. Thus, bearing these principles in mind it is now time to turn to the section to be interpreted.

The liability of the Appellant to income tax under section 33 (1) (c) is clearly mentioned as “.... an amount equal to twenty five per centum of the balance of its profits for that year of assessment after deducting therefrom the tax payable for that year of assessment under paragraph (a):”.

⁶ 2003 (3) Sri L R 43.

⁷ Supra

The above phrase could be arranged in to a formula which for the purposes of convenience and clarity would be termed as formula 1 in this judgment. The said formula 1 would read as follows;

Formula 1

Tax liability⁸ under section 33 (1) (c) = 25% of [Appellant's profits⁹ – tax payable¹⁰ under paragraph (a)]

The phrase 'paragraph (a)' above means section 33(1) (a).

It is clear that the Appellant's liability to income tax in the particular year of assessment under section 33 (1) (a) of the Act shall be an amount calculated on the taxable income of the Appellant for that year of assessment. It must be observed that the term 'taxable income' has specifically been mentioned in this section¹¹.

When one traverses through the provisions of the Inland Revenue Act, it becomes clear;

- i. that it is necessary to ascertain the assessable income of the tax payer in order to determine his taxable income,

⁸ For a given year of assessment.

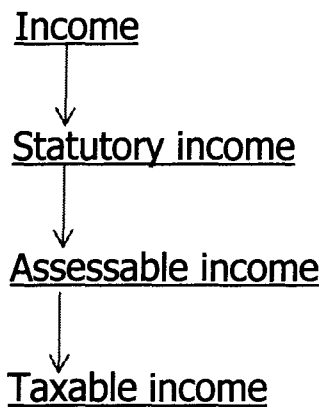
⁹ For that year of assessment.

¹⁰ For that year of assessment.

¹¹ Section 33 (1) (a).

- ii. that it is necessary to ascertain the statutory income of the tax payer in order to determine his assessable income.
- iii. that it is necessary to ascertain the income of the tax payer in order to determine his statutory income.

The above concepts could be organized into a chart which should appear as follows;



Thus, it would be necessary for the tax levying authorities, in order to calculate the tax chargeable from a tax payer, to first identify his income. For an instance section 24 of the Inland Revenue Act, No 28 of 1979 has specified as to what deductions are not allowed in calculating the profits or income of any person. It must be observed that the term used in section

24 also is 'profits or income of any person'. This is a phrase¹² that has been defined in section 163 of the Act.

Once profits or income of the tax payer has been determined the tax levying authorities must then determine the statutory income of the tax payer.

Section 163 of the Act has defined what 'statutory income' is. It is as follows;

"income from any source computed in accordance with section 25".¹³

While section 25 of the Act states the basis for computing the statutory income, section 27 of the Act states how the total statutory income should be calculated.

Once the statutory income of the tax payer has been determined the tax levying authorities must then proceed to determine his assessable income.

The phrase 'assessable income' has been defined in the Act as "the residue of the total statutory income of any person after deducting the

¹² 'profits or income'

¹³ Section 163 of Inland Revenue Act No. 28 of 1979.

aggregate amount of the deductions to which such person is entitled to under section 29".¹⁴

According to section 29 of the Act the assessable income of a person shall be the remainder of his total statutory income after the deductions specified in that section have been made.

Once the assessable income of the tax payer has been determined the tax levying authorities must then determine his taxable income.

The term 'taxable income' has been defined in section 163 of the Act as follows;

"... 'taxable income' means the residue of assessable income of a person after deducting the aggregate amount of the allowances to which such person is entitled to under section 30 ..."

According to section 30 of the Act the taxable income of a person shall be the remainder of his assessable income after the deductions specified in that section have been made.

¹⁴ Section 163 of Inland Revenue Act No. 28 of 1979.

Thus, after deducting from the assessable income, the several allowances permitted by the Act, the remainder would be identified as the taxable income.

It would be of additional value here to reproduce the following passage from the judgment of the Supreme Court in the case of Rodrigo V The Commissioner-General of Inland Revenue¹⁵ ; “The Act prescribes a step by step process wherein exemptions and deductions are permitted when computing the taxable income. To arrive at the taxable income consideration should be given only to the permissible deductions provided by the Act and the Court cannot take into consideration any other means of computing the deductible amounts. ...”.

Thus, it is rather clear that the liability of the Appellant under section 33 (1) (a) would be an amount calculated on his taxable income. And the said taxable income has to be calculated according to the provisions of the Act.

¹⁵ 2002 (1) Sri L R 384.

The said tax liability under section 33 (1) (a) could be formed into another formula which for the purposes of convenience and clarity would be termed as formula 2 in this judgment. The said formula 2 would read as follows;

Formula 2

Tax liability under section 33 (1) (a) = (specified rate¹⁶) x (taxable income)

If the taxable income = 0,

Tax liability under section 33 (1) (a) = (specified rate) x (0)

= 0

Thus, it is clear that if the taxable income of the Appellant is zero then the Appellant's Tax liability under section 33 (1) (a) would also become zero.

In such a situation¹⁷ the application of formula 1¹⁸ would be as follows;

Tax liability¹⁹ under section 33 (1) (c) = 25% of [Appellant's profits²⁰ – tax payable under paragraph (a)²¹]

¹⁶ appropriate rate specified in the Second Schedule to this Act as the rate applicable to companies of that class.

¹⁷ When there is no taxable income.

¹⁸ Tax liability under section 33 (1) (c).

¹⁹ For a given year of assessment.

²⁰ For that year of assessment.

²¹ For that year of assessment.

Since tax payable under paragraph (a) = 0, [because there is no taxable income as shown above]

$$\begin{aligned} \text{Tax liability}^{22} \text{ under section 33 (1) (c)} &= 25\% \text{ of [Appellant's profits}^{23} - 0 \text{]} \\ &= 25\% \text{ of [Appellant's profits}^{24}] \end{aligned}$$

Therefore the tax liability of the Appellant under section 33 (1) (c), would be an amount equal to 25% of [Appellant's profits].

It must be observed that the term used in section 33 (1) (a) is 'taxable income' which, as has already been stated, has been defined in the Act. In contrast, the term used in section 33 (1) (c) is 'profits'. It is thus clear that the legislature in its wisdom has opted not to repeat²⁵ the term 'taxable income' in section 33 (1) (c). Therefore, there is no way that the term 'profits' could be equated to the term 'taxable income'. In any case the term 'taxable income' is a specific term which has a specific definition in the Act.²⁶

This position is further buttressed by the presence of phrase 'the profits on which the taxable income of such corporation is computed' in the proviso

²² For a given year of assessment.

²³ For that year of assessment.

²⁴ For that year of assessment.

²⁵ As in section 33 (1) (a)

²⁶ Section 163.

to section 33 (1) (c). It must be observed that the legislature again in its wisdom has not opted to use a bare term 'profits'²⁷ in the proviso to section 33 (1) (c). The term it has used is 'the profits on which the taxable income of such corporation is computed'. Thus, the legislature has qualified the term 'profits' in the proviso of section 33 (1) (c).

This too shows that what the legislature has meant by the term 'profits' in the main body of section 33 (1) (c) is not what it meant by the term 'taxable income' referred to in section 33 (1) (a).

Further it is important to note that the term 'profits' has also been specifically defined in the Act. To start with, section 3 of the Act has specified the meanings that should be given to the terms "profits and income" or "profits" or "income" for the purposes of the Act. Section 163 then goes on to state that "profits" or "income" means the net profits or income from any source for any period calculated in accordance with the provisions of this Act. Further, chapter IV of the Act has extensively dealt with the question as how one should ascertain profits or income. In that chapter sections 23 and 24 have elaborately dealt respectively with the questions as to what deductions are allowed and what deductions are not

²⁷ As in the main body of section 33 (1) (c).

allowed, when ascertaining profits and income. Thus it is not open to give the term 'profits' which appear in section 33 (1) (c) of the Act, a meaning which is different from what the Act has specifically given to it. It is imperative that the tax payer, the tax levying authorities as well as the Courts interpreting the provisions in the Act must confine themselves to the clear definitions given in the Act.

Indeed the meaning of the proviso above referred to is that the provision in the main body of section 33 (1) (c) is not applicable,²⁸ when the gross dividends the corporation concerned has distributed, out of the profits on which the taxable income is computed, is not less than 25% of [profits of the corporation – tax payable under paragraph (a)].²⁹ Since this refers to an occasion where the corporation concerned has distributed dividends, it is clear that the reference is to a situation where the corporation has generated a taxable income. What it means in other words is that when the aggregate amount of the gross dividends paid by the corporation is not less than the tax liability under section 33 (1) (c), the corporation would not be taxed again separately under section 33 (1) (c) also. Thus the purpose intended by the legislature appears to be to recover to the state at

²⁸ Limb (i) of proviso to section 33 (1) (c).

²⁹ Formula 1.

least a minimum amount equal to 25% of [corporation's profits – tax payable under paragraph (a)]³⁰ either by way of dividends when the corporation has declared dividends or by tax³¹ under section 33 (1) (c) when the corporation has not declared dividends.

The fact that the above is the intended purpose of the legislature becomes manifest from the provisions in limb (ii) in the proviso to section 33 (1) (c). Accordingly the amount of tax charged when the aggregate amount of gross dividends the corporation has distributed is less than 25% of [Appellant's profits – tax payable under paragraph (a)], the tax to which such public corporation is liable under section 33 (1) (c), for the relevant year of assessment, shall be an amount equal to the excess of 25% of [Appellant's profits – tax payable under paragraph (a)] over such amount of such dividends.

To distinguish the relevant differing positions from one another for the purpose of clarity, followings could be stated.

³⁰ Formula 1.

³¹ Known as deemed dividend tax.

- 1) If the tax payable under paragraph (a) **is zero**, then the corporation is liable under section 33 (1) (c), to pay to the state as tax an amount equivalent to 25% of [corporation's profits]. (which is the end result of the computation shown below).

Tax liability³² under section 33 (1) (c) = 25% of [Appellant's profits³³
– tax payable under paragraph (a)³⁴]

Since tax payable under paragraph (a) = 0,

Tax liability³⁵ under section 33 (1) (c) = 25% of [Appellant's profits³⁶
– 0]

= 25% of [Appellant's profits]

- 2) If the tax payable under paragraph (a) **is not zero**, and when the gross dividends the corporation concerned has distributed, out of the profits on which the taxable income is computed, **is not less than** 25% of [profits of the corporation – tax payable under paragraph (a)]

³² For a given year of assessment.

³³ For that year of assessment.

³⁴ For that year of assessment.

³⁵ For a given year of assessment.

³⁶ For that year of assessment.

1,³⁷ the corporation **is not liable** to pay tax under section 33 (1) (c)³⁸ as it has already paid to the state under section 33 (1) (a), an amount either equal or more than it's liability under section 33 (1) (c).

3) If the tax payable under paragraph (a) **is not zero**, and when the gross dividends the corporation concerned has distributed, out of the profits on which the taxable income is computed, **is less than 25%** of [profits of the corporation – tax payable under paragraph (a)],³⁹ the corporation has to pay to the state under section 33 (1) (c),⁴⁰ an additional amount equal to the excess of 25% of [Appellant's profits – tax payable under paragraph (a)] over such amount of such dividends.

The tax liability in such a situation could be formed into a third formula which for the purposes of convenience and clarity would be termed as formula 3 in this judgment. The said formula 3 would read as follows;

³⁷ Formula 1.

³⁸ According to its proviso.

³⁹ Formula 1.

⁴⁰ Limb (ii) in the proviso to section 33 (1) (c).

Formula 3

Tax liability⁴¹ under section 33 (1) (c)⁴² = {25% of [corporation's profits⁴³ – tax payable under paragraph (a)⁴⁴] } – {the amount of the gross dividends the corporation has distributed, out of the profits on which the taxable income is computed}.

It must be made clear that the tax liability computed according to formula 3 above is chargeable in addition to the tax payable under section 33 (1) (a) of the Act.

Thus, the intention of the legislature in enacting section 33 (1) (c) of the Act is clear. It is to deduct the amount of tax levied under section 33 (1) (a) from the tax charged under section 33 (1) (c) avoiding double taxation of corporations.

The Appellant had declared⁴⁵ in its return of income that it has generated a business profit computed in terms of the provisions of the Inland Revenue

⁴¹ For a given year of assessment.

⁴² Limb (ii) in the proviso to section 33 (1) (c).

⁴³ For that year of assessment.

⁴⁴ For that year of assessment.

⁴⁵ Paragraph 2 of the written submission filed by the Appellant.

Act No. 28 of 1979. However it has declared its taxable income as zero. This is presumably in view of a greater amount of a taxable loss which had been brought forward from the previous year. This means that the Appellant has declared 'profits' calculated in accordance with the provisions of this Act in respect of the relevant period within the meaning of section 163 of the Act.

Therefore there is no legal Justification for the Appellant's contention that the term 'profits' referred to in section 33 (l) (c) is the taxable income and not the book profit. Thus, the liability for the Appellant to pay income tax under section 33 (1) (c) of the Act in this instance would be an amount equal to twenty five per centum of his profits. The term 'profits' has been defined in the Act, as has already been shown.

For the foregoing reasons it is the considered view of this court that the Board of Review as well as the Tax Appeals Commission has rightly decided that it is not on the taxable income that the amount equal to twenty five per centum has to be calculated in terms of section 33 (1) (c) of the Inland Revenue Act No.28 of 1979.

As parties have agreed, this interpretation must apply to section 61 (1) (c) of the Inland Revenue Act No. 10 of 2006 (as amended) as well.⁴⁶

Thus, we answer all the four questions⁴⁷ of law formulated for the opinion of this Court in the negative.

In these circumstances we decide to affirm the determination by the Board of Review in C A (Tax) Appeal No. 01/ 2011 as well as the determination by the Tax Appeals Commission in C A (Tax) Appeal No. 21/ 2013 and proceed to dismiss both appeals. No cost is ordered.

JUDGE OF THE COURT OF APPEAL

A H M D Nawaz J

I agree,

JUDGE OF THE COURT OF APPEAL

⁴⁶ i.e. the other case under consideration namely, C A (Tax) Appeal No. 21/ 2013.

⁴⁷ Two in CA (Tax) Appeal No. 01/ 2011 and two in C A (Tax) Appeal No. 21 / 2013.