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

In the matter of the case stated under Reference No. TAC/IT/018/2011 by the Tax Appeals Commission under Section 170(2) of the Inland Revenue Act No.10 of 2006.

RPC Plantation Management Services (Pvt) Ltd.,

No. 310, High Level Road,

Nawinna, Maharagama

Appellant

Case No. CA (Tax) 03/2012

TAC No. TAC/IT/018/2011

Vs.

The Commissioner General of Inland Revenue

Department of Inland Revenue

Sir Chittampalam A.Gardiner Mawatha.

Colombo 02.

Respondent

Before: Janak De Silva J.

Achala Wengappuli J.

Counsel:

F.N. Goonewardena with Peshala Attygalle for the Appellant

N. Wigneswaran S.S.C. for the Respondent

Written Submissions tendered on:

Appellant on 11.06.2018

Respondent on 18.06.2018

Argued on: 06.08.2018

Decided on: 26.10.2018

Janak De Silva J.

The Appellant is a limited liability company whose principle activity is managing and investing in plantations. The main revenue of the Appellant for the year of assessment 2007/2008 was the management fees received from Namunukula Plantations Ltd. The main issue arising for consideration by Court is whether the management fee which has been received by the Appellant from Namunukula Plantations Ltd. for the year of assessment 2007/2008 is entitled to be taxed at the preferential rate of 15% in terms of section 46 of the Inland Revenue Act No. 10 of 2006 (2006 Act) read together with section 45 of the said Act or at the normal rate of 35%.

The Assessor concluded that Namunukula Plantations Ltd. earns profit from cultivation, manufacture and sale of Black Tea, Rubber, Coconut, Oil Palm and other crops and therefore generates income from both cultivation and manufacturing. Accordingly, the profits declared by the Appellant from the provision of management services for Namunukula Plantations Ltd. was proportionately charged for income tax at the rate of 15% and 35% respectively for cultivation and manufacturing on the turn over basis of Namunukula Plantations Ltd.

The Appellant appealed to the Commissioner General of Inland Revenue (CGIR) who determined that the Appellant is not entitled to claim the concessionary rate under section 46 of the 2006 Act as it has not provided management services to Namunukula Plantations Ltd. The CGIR further held that the Appellant had deducted interest expenses amounting to Rs. 16,899,225 from the taxable income when it could not do so. The Tax Appeals Commission (TAC) confirmed the determination of the CGIR and hence the Case Stated was referred to this Court by the TAC on the application of the Appellant.

In terms of section 170 of the 2006 Act, the TAC has sought the opinion of Court on the following questions of law:

(i) Is the Assessment No. 9009553 for the year of assessment 2007/2008 which has been received by the Appellant on 7th October 2009 time barred in terms of section 163(5) of the 2006 Act?

(ii) Is the management fee which has been received by the Appellant from Namunukula Plantations Ltd. for the year of assessment 2007/2008 entitled to be taxed at the rate of 15% in terms of section 46 of the 2006 Act read together with section 45 of the said Act?

(iii) Is the interest expense which has been incurred by the Appellant of Rs. 16,899,225/= for the year of assessment 2007/2008 deductible for income tax under section 25(1)(f) and/or section 32(5) of the 2006 Act?

The learned counsel for the Appellant informed Court that the assessment should have been issued on 30th September 2009 and on the face of the document the notice of assessment is dated 30th September 2009 and the delay prima facie in the receipt of the notice of assessment is only 7 days. Accordingly, the Appellant accepts the position that in the ordinary course of business for the dispatch and receipt of the assessment no. 9009553 for the year of assessment 2007/08 a delay of this nature could be expected. Hence the Appellant is not pursuing this ground of appeal.

The Court appreciates this concession by the learned counsel for the Appellant which has been made in accordance with the best traditions of the Bar which is regrettably a fading tradition.

(ii) Is the management fee which has been received by the Appellant from Namunukula Plantations Ltd. for the year of assessment 2007/2008 entitled to be taxed at the rate of 15% in terms of section 46 of the 2006 Act read together with section 45 of the said Act?

Sections 46(1) of the 2006 Act reads:

> "(1) Where the taxable income of any company for any year of assessment includes any profits and income within the meaning of paragraph (a) of section 3 from any–
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> (a) **agricultural undertaking;**
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> (aa) undertaking for the manufacture of animal feed;
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> (b) undertaking for the promotion of tourism;
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> (c) undertaking for construction work; or
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> (d) undertaking for manufacture of sugar,
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> such part of such taxable income as consists of such profits and income shall, notwithstanding anything to the contrary in other provisions, but subject to the provisions of section 16 of this Act, be chargeable with income tax at the appropriate rate specified in the Fifth Schedule to this Act." (emphasis added)

In terms of section 46(2) of the 2006 Act the expression "agricultural undertaking" shall have the respective meanings assigned to them in section 45 of the 2006 Act.

Section 45(2)(a)(ii) of the 2006 Act reads:

> ""agricultural undertaking" includes any undertaking for—
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> (i) fishing; and
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> (ii) **provision of the services of management to any undertaking for cultivating land with plants of whatever description**;" (emphasis added)

In terms of section 45(2)(b) of the 2006 Act profits and income from any agricultural undertaking means– (i) in the case of an undertaking referred to in subparagraph (ii) of paragraph (a), **the profits and income from fees for providing the services of management**; and (ii) in any other case, the profits and income from the sale of produce of such undertaking without subjecting such produce to any process of production or manufacture.

The Appellant relied on these provisions to submit that the provision of management services to any undertaking for cultivating of land with plants of whatever description is an agricultural activity, and the profit from such undertaking is the fee received for providing management services. Hence the Appellant contended that the management fees received by the Appellant for providing management services to Namunukula Plantations Ltd. should be taxed at the rate of 15% rather than the higher rate of 35%.

The concessionary rate is applicable to the profits and income from fees for providing the services of management. There must be a provision of services. The Appellant is a limited liability company. As a matter of fact, a *company* can only *act through its employees*, from *the* board of directors down. Lord Hoffman in *Meridian Global Funds Management Asia Limited v. The Securities Commission Respondent* [(1995) 2 A.C. 500 at page 506] stated:

> "Judges sometimes say that a company "as such" cannot do anything; it must act by servants or agents. This may seem an unexceptionable, even banal remark. And of course, the meaning is usually perfectly clear. But a reference to a company "as such" might suggest that there is something out there called the company of which one can meaningfully say that it can or cannot do something. There is in fact no such thing as the company as such, no ding an sich, only the applicable rules. To say that a company cannot do something means only that there is no one whose doing of that act would, under the applicable rules of attribution, count as an act of the company."

There is no dispute that during the period under review, the Appellant did not have any employees. No employment costs have been incurred by the Appellant during the year of assessment 2007/2008. How then could the Appellant have provided management services to Namunukula Plantations Ltd.?

Further inquiry reveals that the management address of the Appellant and Namunukula Plantations Ltd. are the same as well as the two companies were managed by the same set of Directors. It is inconceivable how the same persons can both provide and receive management services. Furthermore. the audited annual statements of Namunukula Plantations Ltd. shows that the Board of Directors of the said company is responsible for the system of internal control, asset management, annual planning and control risk management of the company. There was also a management committee and internal audit division reviewing the reports from the management.

The Appellant however submitted that the Inland Revenue Department has entered into settlements with the Appellant for 2009/10 and 2010/11 on the basis that a certain proportion of the Appellants profits should be taxed on the premise that it renders management services related to tea cultivation which is taxed at 15% and a certain proportion of the Appellant's profits should be taxed on the premise that it renders management services related to tea manufacture which is taxed at 35%. It is further stated that it is highly inequitable that the Inland Revenue Department should not agree to settle the taxes payable for the year of assessment 2007/08 on the identical basis. This Court is dealing with a Case Stated referred by the TAC and will be guided by the facts as reflected in the record before Court in determining the questions of law before us. Hence the matter referred to by the Appellant cannot be considered by Court.

For the foregoing reasons, this Court is of the opinion that the payment received by the Appellant purportedly as management fee from Namunukula Plantations Ltd. for the year of assessment 2007/2008 cannot be considered as a management fee. It must be considered as an income received by the Appellant and therefore the Appellant is not entitled to be taxed at the rate of 15% in terms of section 46 of the 2006 Act read together with section 45 of the said Act.

(iii) Is the interest expense which has been incurred by the Appellant of Rs. 16,899,225/= for the year of assessment 2007/2008 deductible for income tax under section 25(1)(f) and/or section 32(5) of the 2006 Act?

The learned counsel for the Appellant in addressing this question of law submitted that the Assessor has not made any assessment on the basis of any part of the interest expense incurred by the Appellant being not deductible and as such the CGIR was not entitled to travel outside the matters considered and determined by the Assessor and introduce in the assessment additional amounts of assessable income which were not the subject matter of the original assessment. He relied on the case of *CIT v. Shapoorji Pallonji Mistry* [(1962) AIR 1086].

However, we are of the view that this is not the question of law referred by the TAC and as such cannot be considered by Court.

The question referred to Court is whether the interest expense of Rs. 16,899,225/= which has been incurred by the Appellant for the year of assessment 2007/2008 is deductible for income tax under section 25(1)(f) and/or section 32(5) of the 2006 Act.

Section 25(1)(f) of the 2006 Act reads:

> "Subject to the provisions of subsections (2) and (4), there shall be deducted for the purpose of ascertaining the profits and income of any person from any source, all outgoings and expenses incurred by such person in the production thereof, including
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> (f) interest paid or payable by such person;"

Section 26(1)(g) of the 2006 Act reads:

> "(1) For the purpose of ascertaining the profits or income of any person from any source, no deduction shall be allowed in respect of –
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> (g) any disbursements or expenses of such person, **not being money expended for the purpose of producing such profits or income**;" (emphasis added)

Clearly these provisions direct that the expenses charged must relate to the trade or business and where it does not so relate the expense shall be disallowed. In *Morgan v. Tate & Lyle Ltd.* [1955] AC 21 at 39 Lord Morton of Henryton held that the words "for the purpose of the trade" mean "for the purposes of enabling a person to carry on and earn profits in the trade" and this phrase is taken from Lord Davey's speech in *Strong & Co. of Romsey Ltd. v. Woodfield* [1906] AC 448 at 453 where he said:

> "These words are used in other rules and appear to me to mean for the purpose of enabling a person to carry on and earn profits in the trade, etc. I think the disbursements permitted are such as are made for that purpose. It is not enough that the disbursement is made in the course of, or arises out of, or is connected with, the trade, or is made out of the profits of the trade. It must be made for the purpose of earning profits."

The sum of Rs. 16,899,225/= is an expenditure on the loans given by the Appellant to its subsidiaries and not for the purpose of managing and investing in plantations. As such when computing the Appellant's taxable income such interest expenses cannot be deducted.

Accordingly, we answer the questions of law arising in the Stated Case as follows:

(i) Is the Assessment No. 9009553 for the year of assessment 2007/2008 which has been received by the Appellant on 7th October 2009 time barred in terms of section 163(5) of the 2006 Act? **No.**

(ii) Is the management fee which has been received by the Appellant from Namunukula Plantations Limited for the year of assessment 2007/2008 entitled to be taxed at the rate of 15% in terms of section 46 of the 2006 Act read together with section 45 of the said Act? **No.**

(iii) Is the interest expense which has been incurred by the Appellant of Rs. 16,899,225/= for the year of assessment 2007/2008 deductible for income tax under section 25(1)(f) and/or section 32(5) of the 2006 Act? **No.**

Accordingly, acting in terms of section 11A (6) of the TAC Act No. 23 of 2011 as amended, we confirm the assessment determined by the TAC.

Judge of the Court of Appeal

Achala Wengappuli J.

I agree.

Judge of the Court of Appeal