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

In the matter of a Case Stated under Reference No. TAC/IT/013/2015 by the Tax Appeals Commission under Section 170 of the Inland Revenue Act No. 10 of 2006 as amended

United Motors Lanka PLC,

No. 100 Hyde Park Corner,

Colombo 02

APPELLANT

Case No. CA/TAX/02/2016

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 for the Appellant

Manohara Jayasinghe State Counsel for the Respondent

Written Submissions tendered on:

Appellant on 03.09.2018

Respondent on 03.09.2018

Argued on: 20.09.2018

Decided on: 14.12.2018

Janak De Silva J.

The Appellant is a limited liability company incorporated in Sri Lanka and its principal business activity is the importation and selling of commercial vehicles and spare parts, after sale services and other related services for motor vehicles.

The Appellant filed its return of income for the year of assessment 2009/2010 on 23rd November 2010. On or around 22nd October 2012 the assessor issued an intimation letter under section 163(3) of the Inland Revenue Act No. 10 of 2006 (IR Act) stating that no deduction is allowable in respect of two thirds of Nation Building Tax (NBT) paid by the Appellant at the customs point on account of it being a prescribed levy or tax in terms of section 26(1)(l)(i) of the IR Act read with Gazette Notification No. 1606/31 dated 19th June 2009.

On or around 30th November 2012 the Respondent issued an assessment on the Appellant for the year of assessment 2009/2010. The Appellant appealed against the said assessment. The Senior Commissioner-Secretariat made a determination on 22nd December 2014 which was communicated by the Respondent to the Appellant by a letter dated 23rd December 2014. The Appellant appealed to the Tax Appeals Commission (TAC) which confirmed the determination made by the Respondent.

The Appellant then moved the TAC to refer the following questions of law for the opinion of Court in terms of section 170 of the Inland Revenue Act No. 10 of 2006:

(1) Was the assessment no. ITA 12301100040V1 dated 30th November 2012(which is the subject matter of this appeal) invalid in law by reason of the previous assessment no. 6476576 V0 dated 6th May 2011 having been issued in respect of the same year of assessment 2009/2010?

(2) Was the assessment for the year 2009/2010 dated 30th November 2012 issued against the Appellant in any case time barred in terms of Section 163(5)(a) of the Inland Revenue Act No. 10 of 2006 (as amended) (the "IRA") as applicable to such year of assessment?

(3) In terms of the IRA read together with the provisions of Extraordinary Gazette No. 1606/31 dated 19th June 2009

   a. Is Nation Building Tax (NBT) paid at the time of importation of goods a "prescribed tax or levy" for the purpose of section 26(1)(l)(iii) of the IRA; or

   b. Is the NBT which is expensed in the financial statements of any person in an year of assessment in accordance with accepted accounting principles a "prescribed tax or levy" for the purposes of section 26(1)(l)(iii) of the IRA for a different year of assessment?

The Appellant has in the written submissions informed Court that Question 1 is not being pursued by the Appellant.

Time Bar

The facts relevant to this question is that the Appellant filed its income tax return for the year of assessment 2009/2010 on 23rd November 2010. The assessor issued an assessment on the Appellant for that year of assessment on 30th November 2012.

The provisions relating to the filing of returns and making of assessments are set out in sections 106(1) and 163(5) respectively of the Inland Revenue Act No. 10 of 2006 (IR Act). Accordingly, every person who is chargeable with income tax under this Act for any year of assessment shall, on or before the thirtieth day of September immediately succeeding the end of that year of assessment file a return and where the return is filed within this time, an assessment of the

income tax payable by such person must be made before the expiry eighteen months from the end of that year of assessment.

Sections 106(1) and 163(5) of the IR Act was amended by Act No. 19 of 2009 which resulted in the filing of returns having to be done on or before the thirtieth day of November immediately succeeding the end of that year of assessment and the assessment having to be done before the expiry of two years from the end of that year of assessment.

Accordingly, the Appellant submits that any assessment relating to year of assessment 2009/2010 should have been issued before 31st March 2012 (i.e. 2 years after 31st March 2010) whereas it was issued only on 29th November 2012, which is almost 8 months after the deadline.

However, the learned State Counsel for the Respondent submits that this submission ignores the amendment made to sections 106(1) and 163(5) of the IR Act by Act No. 22 of 2011. He submitted that prior to the amendment the two-year period commenced on 1st April i.e. the very date after the conclusion of the year of assessment but after the amendment the commencement date was changed to 30th November.

He further submitted that the Appellant submitted his return on 23rd November 2010 at which point the law in operation was the pre-2011 law according to which the two-year period within which the notice of assessment must be sent would conclude on 01st April 2012. It was submitted that if there was no change in the legal regime then the Appellant was entitled to assume on 1st April 2012 that his tax returns were accepted. However, the learned State Counsel submits that after the Appellant submitted his return but very importantly before 1st April 2012, the law was amended as a result of which the deadline for sending out a notice of assessment to the Appellant gets extended to 30th November 2012.

However, the learned counsel for the Appellant rejects this position and submitted that these amendments would come into operation for the year of assessment 2011/2012 and not to the previous year of assessment. In particular he directed the attention of court to the fact that the amendment made in 2011 takes effect on 1 April 2011 which is significant as it shows that the amendment was to take effect at the beginning of the year of assessment 2011/2012 although certified on 31st March 2011.

A similar issue arose sometime ago when the amendment to the IR Act in 2009 was the subject matter in *Seylan Bank PLC. v. The Commissioner General of Inland Revenue* [CA(Tax) 23/2013, C.A.M. 23.05.2015]. In that case this Court held that irrespective of whether the assessee had to submit the tax return on or before the 30th September or 30th November 2009, the assessor can send the assessment to the assessee within two years immediately succeeding that year of assessment. The Court further considered the amendments made to section 163 of the IR Act by Act Nos. 22 of 2011, 18 of 2013 and 8 of 2014. It held that the two-year period given to the assessor to send the assessment against the assessee was to start from the end of the year of assessment originally, which is the 31st of March, every year. This date (the starting day of the period) has been further pushed down to the thirtieth day of November of the immediately succeeding year of assessment by Act No. 22 of 2011. The Court also held that section 163(5) of the IR Act is a procedural law and that even if the amendment has retrospective effect, it applies, if the amendment is only on procedural law.

Two judges sitting together as a rule follow the decision of two judges. Where two judges sitting together find themselves unable to follow a decision of two judges, the practice in such cases is also to reserve the case for the decision of a fuller bench [*Walker Sons & Co. (UK) Ltd. v. Gunatilake and others* (1978-79-80) 1 Sri.L.R. 231]. In any event, I am of the view that the reasoning in *Seylan Bank PLC. v. The Commissioner General of Inland Revenue* (supra) is sound and compelling and sets out the correct position in law.

I only wish to add that it is a recognized principle that in fiscal legislation it is a matter for the legislature to decide what consideration relating to the amelioration of hardship or to the interests of the economic progress of the people should be given effect to and economic considerations in respect of which such decisions are made must be largely left to the legislature in view of the inherent complexity of fiscal adjustment of diverse elements that requires to be made. [Inland Revenue (Amendment) Bill, S.C.S.D. 3/1980].

Prescribed Tax or Levy

In ascertaining profits or income for the purposes of the IR Act, the Appellant is entitled to deduct all outgoings and expenses. However, section 26 of the IR Act identifies certain non-deductibles in ascertaining profits or income. The question for determination is whether NBT paid at the time of importation of goods is not a "prescribed tax or levy" for the purpose of section 26(1)(l)(iii) of the Inland Revenue Act No. 10 of 2006 (as amended).

Section 2(1) of the Nation Building Tax Act No. 9 of 2009 as amended (NBT Act) states that the provisions of the Act apply to every person who:

(a) imports of any article, other than any article comprised in the personal baggage of the passenger, into Sri Lanka, ["baggage" shall have the same meaning as in section 107A of the Customs Ordinance (Chapter 235)]; or

(b) carries on the business of manufacture of any article; or

(c) carries on the business of providing a service of any description: or

(d) carries on the business of wholesale or retail sale of any article other than such sale by the manufacturer of that article being a manufacturer to whom the provisions of paragraph (b) applies.

The Appellant is an importer of vehicles and therefore pays NBT on its imports. In ascertaining its profits or income the Appellant deducted the NBT paid by it whereas the assessor and the Respondent took the position that it was not possible to do so and rejected the return and issued a new assessment. In appeal the Respondent and the TAC concurred with this conclusion of the assessor. It is in this context that question no. 2 was referred to this Court by the TAC.

NBT is not specifically identified in section 26 of the IR Act as a non-deductible. In the absence of any other provision, the Appellant is then entitled to deduct the NBT paid by it at the time of importation. However, section 26(1)(l)(iii) of the IR Act states that for the purposes of ascertaining the profits or income of any person from any sources no deduction shall be allowed in respect of "any prescribed tax or levy".

The prohibition in section 26(1)(l)(iii) of the IR Act in effect acts as an exemption when a person is not caught up within it as then the person can deduct all the expenses and outgoings of his business before calculating the taxable income. Exemption notifications must be interpreted strictly and, in its entirety, and not in parts [*Grasim Industries Ltd. & Anvor v. State of Madhya Pradesh & Anvor and Gwalior Sugar Co. Ltd. v. Madhya Pradesh Electricity Board & Ors* (1999) 8 SCC 547].

In *Zebra Technologies Corporation v. Judy Baar Topinka, as Treasurer of the State of Illinois, and The Department of Revenue* [799 N.E.2d 725 (2003), 344 Ill. App.3d 474, 278 Ill.Dec. 860] the Appellate Court of Illinois, First District, First Division held:

> "We are mindful that taxation is the rule and tax exemption is the exception. *Chicago Bar Ass'n v. Department of Revenue*, 163 Ill.2d 290, 301, 206 Ill.Dec. 113, 644 N.E.2d 1166 (1994). Here, taxpayer is claiming an exemption from tax on income that would otherwise be assessed but for the 80/20 rule. Thus, taxpayer has the burden of proving clearly that it comes within the statutory exemption. *United Air Lines, Inc. v. Johnson*, 84 Ill.2d 446, 455-56, 50 Ill.Dec. 631, 419 N.E.2d 899 (1981). Such exemptions are to be strictly construed, and doubts concerning the applicability of the exemptions will be resolved in favor of taxation. *United Air Lines*, 84 Ill.2d at 455, 50 Ill.Dec. 631, 419 N.E.2d 899."

Regulations made by the Minister under section 212 of the IR Act read with section 26 therein and published in Gazette Notification No. 1606/31 dated 19.06.2009 (Regulation) reads:

> *"Two thirds of the Nation Building Tax charged by the Nation Building Tax Act, No. 9 of 2009 payable for the period commencing on May 1, 2009 and ending on June 30, 2009, and for every quarter commencing on or after July 1, 2009, shall for the purposes of sub-paragraph (iii) of paragraph (l) of sub-section (1) of section 26 of the Inland Revenue Act No. 10 of 2006 be a prescribed levy".*

Hence, a portion of the NBT has been made a prescribed levy for the purposes of section 26(1)(l)(iii) of the IR Act. However, the Appellant contends that it has been made a prescribed levy only for the persons who pay NBT quarterly whereas the Appellant pays NBT at the point of importation on each article and therefore is not caught within the prohibition on deduction.

The Respondent on the other hand submits that the prohibition on deduction in terms of section 26(1)(l)(iii) of the IR Act covers all three persons referred to in section 2 of the IR Act including the Appellant and therefore the Appellant is not entitled to deduct the NBT paid by it on its imports.

In order to have a better understanding of the competing positions, it is important to examine certain other provisions in the NBT Act. Section 3(1) of the NBT Act reads:

> 3. (1) A tax to be called the "Nation Building Tax" (hereinafter referred to as "the Tax") shall, subject to the provisions of this Act, be charged from every person to whom this Act applies calculated at the appropriate rate specified in the Second Schedule to this Act, in the following manner: -
>
> (i) in the case of a person referred to in paragraph (a) of subsection (1) of section 2, who imports any article into Sri Lanka on or after January 1, 2009 the tax shall be chargeable in respect of the liable turnover of such person arising from the importation into Sri Lanka of such article; and
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> (ii) in the case of a person referred to in paragraph (b) (c) or (d) of subsection (1) of section 2, for every quarter commencing on or after January 1, 2009 (hereinafter referred to as "relevant quarter", the tax shall be chargeable in respect of the liable turnover of such person for such relevant quarter.

Section 3(1) of the NBT Act deals with two separate and distinct incidents of the taxing regime. The first part is the charging section by which NBT is charged on every person to whom the Act applies, namely the persons referred to in section 2 of the NBT Act. The second part deals with the calculation of the NBT. Accordingly, NBT is calculated at the appropriate rate specified in the Second Schedule thereto in the case of importers of any article on the liable turnover of such person arising from the importation into Sri Lanka of such article and in the case of a person referred to in paragraph (b) (c) or (d) of subsection (1) of section 2, the NBT is calculated on the liable turnover of such person for such relevant quarter.

The Respondent has based its argument on the reference to quarter in the Regulation and submits that as an importer it does not pay NBT quarterly but only in respect of the liable turnover of such person arising from the importation into Sri Lanka of such article and as such the NBT it pays on every import is not a prescribed tax or levy.

I am unable to accede to this submission. The Regulation covers both the charging section as well as the calculation part referred to above. That is why the Regulation reads " ***Two thirds of the Nation Building Tax charged by the Nation Building Tax Act, No. 9 of 2009*** *payable for the period commencing on May 1, 2009 and ending on June 30, 2009, and for every quarter commencing on or after July 1, 2009...".* If one were to accept the submission of the Appellant it would amount to excluding part of the Regulation in its interpretation.

Furthermore, as the learned Senior State Counsel correctly submitted if the Minister actually intended to exclude importers from the application of the Regulation he could easily have done so by referring to only the categories of enterprises referred to in paragraphs b), c) and d) of Section 2(1) of the NBT Act.

In any event, the Appellant submits that the financial statements of the Appellant are prepared on an accruals basis and not on a payment basis and accordingly, for income tax purposes as well this basis is considered to be acceptable. It is submitted that if the Appellant effects any imports and such imported items remain unsold at the end of the financial year, and are sold in subsequent financial year, the cost of such imports would get recorded as an expense only in the subsequent year. Accordingly, the Appellant submitted that if the contention of the Respondent is accepted such add back would occur in the year in which the NBT was collected at customs point even though the financial statements itself for such year has not considered such NBT as part of the costs of the goods sold.

The purpose of accounting is usually to provide information to interested parties relevant to stewardship, control and decision-making. The requirements of a tax system can be quite different. In *Thor Power Tools Company v. Commissioner of Internal Revenue* [58L Ed. 2d.785 at 802 (1979)] the US Supreme Court stated:

> "The primary goal of financial accounting is to provide useful information to management, shareholders, creditors, and others properly interested; the major responsibility of the accountant is to protect these parties from being misled. The primary goal of the income tax system, in contrast, is the equitable collection of revenue; the major responsibility of the Internal Revenue Service is to protect the public fisc. Consistently with its goals and responsibilities, financial accounting has as its foundation the principle of conservatism, with its corollary that 'possible errors in measurement [should] be in the direction of understatement rather than overstatement of net income and net assets'. In view of the Treasury's markedly different goals and responsibilities, understatement of income is not destined to be its guiding light. Given this diversity, even contrariety of objectives, any presumptive equivalency between tax and financial accounting would be unacceptable".

Accordingly, I reject the submission of the Appellant that any inconsistency between the financial accounting practices and taxing provisions must be avoided.

For the reasons aforesaid, Court answers the following questions of law as follows:

(1) Was the assessment no. ITA 12301100040V1 dated 30th November 2012(which is the subject matter of this appeal) invalid in law by reason of the previous assessment no. 6476576 V0 dated 6th May 2011 having been issued in respect of the same year of assessment 2009/2010? **No.**

(2) Was the assessment for the year 2009/2010 dated 30th November 2012 issued against the Appellant in any case time barred in terms of Section 163(5)(a) of the Inland Revenue Act No. 10 of 2006 (as amended) (the "IRA") as applicable to such year of assessment? **No.**

(3) In terms of the IRA read together with the provisions of Extraordinary Gazette No. 1606/31 dated 19th June 2009

a. Is Nation Building Tax (NBT) paid at the time of importation of goods a "prescribed tax or levy" for the purpose of section 26(1)(l)(iii) of the IR Act? **Yes**

b. Is the NBT which is expensed in the financial statements of any person in an year of assessment in accordance with accepted accounting principles a "prescribed tax or levy" for the purposes of section 26(1)(l)(iii) of the IRA for a different year of assessment? **Yes**

For the reasons aforesaid, this Court confirms the Determination of the TAC.

The Registrar is directed to send a certified copy of this judgment to the TAC.

Judge of the Court of Appeal

Achala Wengappuli J.

I agree.

Judge of the Court of Appeal