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

Gabo Travels (Private) Limited.,
No. 11,
Bagatale Road,
Colombo 3.
Appellant

CA CASE NO: CA/TAX/12/2014
TAX APPEAL COMMISSION CASE NO: TAC/IT/001/2013

Vs.

Commissioner General of Inland Revenue,
Department of Inland Revenue,
Sir Chittampalam A. Gardiner Mawatha,
Colombo 2.
Respondent

Before: K.K. Wickramasinghe, J.
Mahinda Samayawardhena, J.

Counsel: Riad Ameen for the Appellant.
Farzana Jameel, A.S.G., for the Respondent.

Decided on: 05.12.2019

Mahinda Samayawardhena, J.

This is an appeal by way of a case stated under section 11A of the Tax Appeals Commission Act, No. 23 of 2011, as amended.

The principal question of law referred for the opinion of this Court is whether the monies received by the appellant, during the year of assessment 2008/2009, as interest on fixed deposits, shall be treated as business income in terms of section 3(a) of the Inland Revenue Act, No. 10 of 2006, as amended, in which event, the appellant has to pay a lower rate of tax, or as separate interest income in terms of section 3(e) of the Act, in which event, the appellant has to pay a higher rate of tax.

The Assessor, the Commissioner General of Inland Revenue and the Tax Appeals Commission decided that, in the facts and circumstances of this case, the interest on fixed deposits is a separate source of income and not a source of income received from the appellant's core business of travel agency.

The position of the appellant is that interest income from banks on account of fixed deposits is part of its business profits under section 3(a) of the Act.

The appellant states that in order to conduct its business of travel agency, the appellant has to provide bank guarantees to all airlines to cover volume of sales, and fixed deposits are pledged as collaterals in banks for the purpose of obtaining bank guarantees; therefore, opening fixed deposits in banks is part of the business of the appellant, and, for the same reason, the

interest received shall be treated as a source of income under section 3(a), and not under 3(e) of the Act.

Providing bank guarantees to the airlines may be an essential feature of the appellant's business. In order to get bank guarantees, the appellant may be giving fixed deposits as collateral. Fixed deposits are not the only collateral banks accept to issue bank guarantees. Any asset acceptable to the bank as security can be considered collateral.

There is no issue with the appellant deciding to provide fixed deposits as collateral to obtain bank guarantees. But the interest on the said fixed deposits cannot be tied up with the business profit.

To take another example, if the appellant gives as collateral a large business premises owned by the appellant (purchased out of its business profits) to obtain a bank guarantee, can the appellant state that the substantial income generated by renting out the said business premises to third parties is also travel business income? He cannot. That is a separate investment and separate income.

In my view, there is no room for hair-splitting arguments on this matter. The answer is straightforward.

However, as the learned counsel for the appellant took pains during the course of argument to dissect the Five Judge Bench decision of the Supreme Court in *Ceylon Financial Investments Ltd. v. Commissioner of Income Tax*[1] (which is considered to be

[1] (1941) 1 CTC 206 and (1941) 43 NLR 1

the leading local case on this issue) in quest of finding the *ratio decidendi* in that Judgment, as (according to the learned counsel) the headnote of the reported Judgment is misleading, let me now advert to that Judgment.

I must make it clear that I did not independently consider the *ratio decidendi* of the Judgment of *Ceylon Financial Investments Ltd. v. Commissioner of Income Tax*, but will rely on, for the purpose of this case, the version of the learned counsel for the appellant on that matter.

The learned counsel for the appellant has stated in the written submission that, according to Howard C.J. and Keuneman J., for section 6(1)(e) to apply in relation to interest (a) the business shall consist only of receipt of interest; or (b) the business of receiving interest can be clearly separated from the rest of the business.[2]

Howard C.J. formulated the following test:

> *If the business of a company consists in the receipt of dividends, interest or discounts alone or if such a business can be clearly separated from the rest of the trade or business, then any special provisions applicable to dividends, interest or discounts must be applied.*[3]

Keuneman J. expressed the same test in almost identical words:

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[2] Section 6(1)(a) and section 6(1)(e) of the Income Tax Ordinance correspond to section 3(a) and section 3(e) of the Inland Revenue Act, respectively.
[3] CTC at page 250 and NLR at page 11.

> *If then the business of an individual or a company consists in the receipt of dividends, interest or discounts alone, or if the business of receiving dividends, interest or discounts can be clearly separated from the rest of the trade or business, then any special provisions applicable to dividends, interest or discounts must be applied.*[4]

Admittedly, (a) above is inapplicable to the appellant's case.

In regard to (b) above, the learned counsel states that as the appellant earned interest from fixed deposits used as collateral to bank guarantees needed for its business, there was no clear separation.

As I have already explained, this argument is unacceptable. Receipt of interest from fixed deposits can be clearly separated from the rest of the business of the appellant.

According to the learned counsel for the appellant, Wijewardene J. took the view that the Commissioner General of Inland Revenue has the option to select between section 6(1)(a) and 6(1)(e). That test is against the appellant.

During the course of argument, learned counsel for the appellant stated that the preferred test is that of Soertsz J., which is clear and simple.

De Kretser J., without writing a separate Judgment, has merely agreed with Soertsz J.

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[4] CTC at page 261-262 and NLR at page 20.

The learned counsel for the appellant has quoted, in the written submission, the following portion of the Judgment of Soertsz J., as reflecting the test suggested by Soertsz J.

> *The view I have reached is that the categories enumerated in section 6(1) are mutually exclusive, and that the question whether 6(1)(a) or 6(1)(e) applies in a particular case, depends on whether we are dealing with the profits of a business or the income of an individual. If it is a case of dividends, interests, or discounts appertaining to a business, they fall within the words "profits of any business" and section (6)(1)(a) applies. If, however, it is a case of dividends, interest or discounts accruing to an individual not, in the course of a business, but as a part of his income from simple investments, then section 6(1)(e) is the relevant section, and so far as interest is concerned, section (9)(3) modifies section 9(1).*[5]

Then the learned counsel submits:

> *The test laid down by Soertsz J. is a very simple test. It requires a taxpayer to be classified as a business or an individual. If it is a business, then section 6(1)(a) applies. If it is an individual, then section 6(1)(e) applies. The appellant in this instant case is not an individual. The appellant is a company engaged in business. Therefore, applying the test of Soertsz J. interest earned by the appellant would have had to be treated as source under section 6(1)(a).*

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[5] CTC at page 252 and NLR at page 13.
Section 6(1)(a) and section 6(1)(e) of the Income Tax Ordinance correspond to section 3(a) and section 3(e) of the Inland Revenue Act.

I am afraid I cannot agree with that argument. The test of Soertsz J. is not that simple—"*a taxpayer to be classified as a business or an individual*". According to that argument, a company is not caught up either in section 6(1)(a) or section 6(1)(e), as it is neither a "business" nor an "individual"! There cannot be any dispute that a "business" can be carried on by a "company" or an "individual" (if a company cannot be considered an individual).

The missing of the words "or company" after the word "individual" need not be given undue importance. By reading the Judgment of Soertsz J. as a whole, I have no scintilla of doubt that Soertsz J. never intended to make a distinction between a company and an individual. The gist of the test of Soertsz J., is: if interest appertains to a business, the interest falls under section 6(1)(a); if interest appertains to an individual not in the course of business, but as a part of his income from simple investments, then the interest falls under section 6(1)(e).

Here "individual" means "person", which includes "a company or body of persons or any government".[6]

The test of Soertsz J. is substantially similar to the one suggested by Howard C.J. and Keuneman J.

In my view, the Judgment of *Ceylon Financial Investments Ltd. v. Commissioner of Income Tax* does not favour the appellant.

It appears that the present trend seems to be to apply the test of "integral part of the business" to resolve this issue, which

[6] Vide section 217 of the Inland Revenue Act, No.10 of 2006, as amended.

recognises that even interest from investment income can constitute business income, if making investments is an integral part of the business.[7] This test is in favour of the taxpayer. However, this test will not help the appellant in the instant case as the fixed deposit investment cannot be regarded as an integral part of the appellant's business upon the reasons I have discussed above.

Hence, I answer the principal question of law mentioned above against the appellant.

Appeal is dismissed with costs.

Judge of the Court of Appeal

K.K. Wickremasinghe, J.
I agree.

Judge of the Court of Appeal

[7] Vide Nuclear Electric PLC v. Bradley [1995] STC 1125, which has been referred to in the determination of the Tax Appeals Commission.