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

In the matter of an appeal by way of Stated Case on a question of law for the opinion of the Court of Appeal under and in terms of Section 11A of the Tax Appeals Commission Act, No. 23 of 2011 (as amended).

Mrs. C. S. D. B. Mutunayagam,
Catherine Tradings,
469/8, Sirimavo Bandaranayake Mawatha,
Colombo 14.

Appellant

Case No. CA/TAX/48/2019
Tax Appeals Commission
No. TAC/IT/068/2016

Vs.

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

Respondent

Before : Dr. Ruwan Fernando J. &

M. Sampath K.B. Wijeratne J.

Counsel : Dr. Shivaji Felix for the Appellant

Chaya Sri Nammuni, S.S.C. for the Respondent

Argued on : 21.02.2021, 22.02.2021, 08.03.2021 & 31.03.2021

Written Submissions filed on	:	10.08.2020 & 28.04.2021 (by the Appellant) 10.05.2021 (by the Respondent)
Decided on	:	30.07.2021

<u>Dr. Ruwan Fernando, J.</u>

Introduction

[1] This is an Appeal by the Appellant by way of a Stated Case against the determination of the Tax Appeals Commission dated 01.10.2019 confirming the determination of the Respondent dated 27.09.2016 and dismissing the Appeal of the Appellant. The period relates to the assessment years 2011/2012 & 2012/2013.

Factual Background

[2] The Appellant Mrs. C.S.D.B. Muthunayagam is the sole proprietor of Catherine Tradings and received rental income by leasing out her premises to several companies for various storing purposes. The Appellant submitted her returns for the said years of assessment, claiming a concessionary rate of 10% provided under and in terms of Item 31 of the Fifth Schedule to the Inland Revenue Act, No. 10 of 2006 as amended. The Appellant further claimed deductions on the interest paid in respect of overdrafts in terms of Section 25 of the said Act, or in the alternative, deductions under and in terms of Section 32 (5) of the said Act.

[3] The Senior/Deputy Commissioner by letter dated 20.08.2014 refused to accept the returns and issued assessments for the following reasons:

1. As per Section 217 of the Inland Revenue Act, letting or leasing of premises by a company has been defined as a business, but letting or leasing of premises by an individual is not defined as a business and as the rental income is within the meaning of source of "rents", deductions are permitted only in respect of rates and repair allowance;

2. Though the concessionary tax rate of 10% is applicable for any undertaking carried on in Sri Lanka for operation and maintenance of facilities for storage, the Appellant is not an undertaking engaged in the business of operating and maintaining facilities for storage;

3. As per the lease agreements, the activity of the Appellant is confined to the renting out the premises, which does not fall into the category of the

operation and maintenance of facilities for storage and thus, the concessionary rate of 10% is not applicable under Item 31 of the Fifth Schedule to the Inland Revenue Act;

4. Interest paid on loans in a sum of Rs. 213,196/- is permitted under Section 32 (5) of the Inland Revenue Act for the assessment year of 2011/12 and a sum of Rs. 879,645/- is permitted for the assessment year of 2012/2013 but the interest paid on overdrafts is not permitted due to the absence of documentary evidence.

[4] The Appellant appealed to the Respondent against the said assessments and the Respondent by its determination dated 27.09.2016 revised the said years of assessments 2011/2012 and 2012/2013 (Vide- pages 2-4 of the TAC brief).

Appeal to the Tax Appeals Commission & the Court of Appeal

[5] Being dissatisfied with the said determination of the Respondent, the Appellant appealed to the Tax Appeals Commission and the Tax Appeals Commission by its determination dated 01.10.2019 confirmed the determination of the Respondent. Being dissatisfied with the said determination of the Tax Appeals Commission, the Appellant appealed to the Court of Appeal and formulated the following Four Questions of Law in the Case Stated for the opinion of the Court of Appeal.

1. Is the assessment, as confirmed by the determination of the Tax Appeals Commission excessive and without lawful justification?
2. In view of the fact that the rate of tax applicable to a person carrying out an undertaking providing storage facilities is 10%, under and in terms of Item 31 of the Fifth Schedule to the Inland Revenue Act, No. 10 of 2006 (as amended), is the Appellant entitled to the benefit of this concessionary tax rate?
3. Is the Appellant entitled to claim interest paid in respect of overdrafts as permissible deductions in terms of Section 25 of the Inland Revenue Act, No. 10 of 2006 (as amended) or in the alternative, as a deduction under and in terms of Section 32 (5) of the Inland Revenue Act, No. 10 of 2006 (as amended)?
4. In view of the facts and circumstances of the case, did the Tax Appeals Commission err in law in coming to the conclusion that it did?

[6] At the hearing of the Appeal, Dr. Shivaji Felix, the learned Counsel for the Appellant and Mrs. Chaya Sri Nammuni, the learned Senior State Counsel for the Respondent made extensive oral submissions.

Question of Law No. 1

Whether the assessment, as confirmed by the determination of the Tax Appeals Commission is excessive and made without lawful justification

Question of Law No. 2

Whether the Appellant is entitled to the benefit of a 10% concessionary tax rate under and in terms of Item 31 of the Fifth Schedule to the Inland Revenue Act, No. 10 of 2006

[7] At the hearing Dr. Shivaji Felix submitted that the Tax Appeals Commission has erred in relying on the erroneous ruling bearing No. Act/03/15/ Ref. No. IC 2014/62 made by the Committee for Interpretation of Tax Laws dated 29.05.2015. By the said Interpretation, the Committee, has ruled that (i) the undertaking referred to in Item 31 means a kind of business and the term "business" has been defined in Section 217 of the Inland Revenue Act, referring to a company; and (ii) the letting or leasing of premises is treated as a business for the purpose of Item 31, only if such activity is carried out by a company (pp. 76-77 of the brief).

[8] Dr. Shivaji Felix further submitted that the concept of "undertaking" in Item 31 is wider than the concept of "business", referred to in Section 217, which encompasses a number of different activities including the rental income received by the Appellant from warehouses and Item 31 of the Fifth Schedule to the Act applies to both individuals and companies. He referred to the Sinhala version of Item 31 of the Inland Revenue Act and submitted that it refers to both profits and income of an undertaking and that it makes reference to an "individual" and thus, the concessionary rate in Item 31 applies both to business profits and income of such an undertaking who is either an individual or company. On this basis, Dr. Shivaji Felix contended that the concessionary tax rate referred to in Item 31 applies to an individual who is engaged in renting warehouses, and thus, the income received by the Appellant from renting warehouses qualifies for the preferential rate of tax, independent of whether rents received by such individual constitute business income or rental income.

[9] The learned Senior State Counsel while conceding that an undertaking can and does include "business" as held by this Court in *Polychrome Electrical*

Industries (Pvt) Ltd v. Commissioner General of Inland Revenue (CA Tax/49/2019) decided on 26.03.2021, submitted that the rent and income from rent is treated differently in the Inland Revenue Act and in terms of the definition of the term "business" in Section 217, the letting or renting out a warehouse becomes a business when it is done by a company. She submitted that accordingly, the business income of an individual cannot be treated as business income for the purpose of granting concession under Item 31 of the Fifth Schedule to the Inland Revenue Act.

[10] The Tax Appeals Commission, in its determination dated 01.10.2019 stated that the concessionary rate of tax set out in Item 31 does not apply to the Appellant for the following reasons:

1. The term "undertaking" means a kind of a business and the term "business" has been defined in Section 217 of the Inland Revenue Act, which restricts the letting or leasing of any premises by a company and not by an individual;
2. Even though the Appellant has rented out her premises to several companies for storage purposes, the Appellant was not involved in the business of operating and maintaining facilities for storage and therefore, the Appellant cannot rely on the concessionary tax benefit under Item 31 of the Fifth Schedule to the Inland Revenue Act as amended;
3. The activity carried out by the Appellant was only renting out her premises to others to be used for storage purposes, which falls under Section 3 (g) of the Inland Revenue Act and thus, the Appellant's activity of renting out the premises cannot be treated as an undertaking or as a business;
4. The Appellant's activity of renting out her premises should be calculated in terms of Section 6 of the Inland Revenue Act and thus, the Appellant is not entitled to the concessionary tax rate provided in Item 31 of the Fifth Schedule to the Inland Revenue Act as amended;

[11] The findings of the Tax Appeals Commission at pages 458 and 459 are as follows:

> *"However, it must be stated that "undertaking" means a kind of a business and the term "business" has been defined in Section 217 of the Inland Revenue Act, which restricts the letting or leasing of any premises to a company and not an individual. That is how the definition of the term "business" is defined in Section 217 of the Inland Revenue Act. Therefore, one cannot take a different view, disregarding the definition of the term "business" given in Section 217 of the Act. Besides, the activity carried out*

by the Appellant is clearly renting of premises, which will fall under Section 3 (g) of the Inland Revenue Act. Therefore, the Appellant's activity of renting of premises cannot be treated as an undertaking or as a business. Hence, Appellant is not entitled to the concessionary tax rate provided in Item 31 of the Fifth Schedule to the Inland Revenue Act as amended....(p.458)

Even though these premises are rented out for the storage purposes, the activity carried out by the Appellant is renting. In fact, the Appellant submitted her returns for the two years of assessment 2011/2012 and 2012/2013, declaring her rent income under Section 3 (g) of the Inland Revenue Act. Therefore, rental income should be calculated in terms of Section 6 of the Inland Revenue Act......It is due to this reason that, even the Committee for Interpretation of Tax Laws of the Inland Revenue Department, decided that the Appellant was not involved in the business of operating and maintaining facilities for storage, but the Appellant was only renting out her premises to others to be used for storage purposes. Under these circumstances, the Appellant is not entitled to claim the tax concession provided in terms of Item 31 of the Fifth Schedule to the Inland Revenue Act (pp. 458-459)".

[12] In view of the rival submissions made by both Counsel, this Court is invited to determine the following four issues:

1. Whether the concessionary tax rate of 10% under and in terms of Item 31 of the Fifth Schedule to the Inland Revenue Act applies only to the business income of a company in view of the definition of the term "business" in Section 217 of the Inland Revenue Act;

2. Even if Item 31 of the Fifth Schedule applies to an individual, whether the Appellant constitutes an undertaking carried on the business of operating and maintaining facilities for storage within the meaning of Item 31 of the Fifth Schedule to the Inland Revenue Act;

3. On the facts and circumstances of this case, whether the income received by the Appellant from leasing out her property is to be treated as business income or rental income from her property;

4. On the facts and circumstances of this case, whether the Appellant is entitled to a concessionary tax rate under Item 31 of the Fifth Schedule to the Inland Revenue Act.

Undertaking set out in Item 31 of the Fifth Schedule to the Inland Revenue Act, No. 10 of 2006, as amended

[13] Before proceeding to deal with the issues involved in the first and second Questions of Law, I shall refer to the relevant provisions of the Inland Revenue Act, No. 10 of 2006, as amended. Item 31 of the Fifth Schedule makes

provisions for the concessionary rate of income tax applicable to any undertaking carried on in Sri Lanka for operation and maintenance of facilities for storage, development of software or supply of labour. Item 31 of the Fifth Schedule to the Inland Revenue Act, No. 10 of 2006, as amended reads as follows:

31. The rate of income tax applicable to any undertaking carried on in Sri Lanka **for operation and maintenance of facilities for storage,** development of software or supply of labour.	As per the First Schedule, but subject to a maximum of **10 per centum for an individual**, and **10 per centum for a company.**

[14] One has to consider the object of granting tax concessions to an undertaking under Item 31 and thus, the said expression "undertaking" will have to be construed liberally in a broader commercial sense, keeping its object and context in mind. In the process of construing the object and context of Item 31, we have to consider whether the concession afforded to an undertaking is confined to a company, and if it applies to an individual, whether the nature of the business activity of such individual qualifies for the tax concession under Item 31 of the Fifth Schedule to the Inland Revenue Act.

Meaning of the expression "undertaking"

[15] The term "undertaking" used in Item 31 of the Inland Revenue Act has not been defined in the Inland Revenue Act. The expression "undertaking" has different shades of meaning and is the most elastic and broad in nature. "Undertaking" in common parlance means an "enterprise", "business", "venture" or "engagement" etc. According to Online Dictionary, Merriam Webster, "undertaking" means, "anything undertaken, any business, work, or project which one engages in, or attempts, an enterprise or venture or engagement in the context in which it occurs".

[16] The Kerala High Court had occasion to expound this term "undertaking" and "industrial undertaking" in the Indian Income Tax Act, 1961 in the case of *P. Alikunju M.A. Nazeer Cashew Industries v. CIT*, 166 ITR 804. The High Court stated in paragraphs 5 and 6:

> *"5. What then is an "industrial undertaking"? The Income-tax Act does not define what is "an undertaking" or what is an "industrial undertaking". It has, therefore, become necessary to construe these words. Words used in a statute dealing with matters relating to the general public are presumed to have been used in their popular rather than their narrow, legal or technical sense. Loquitur ut vulgus, that is, according to the common understanding and acceptance of the terms, is the doctrine that*

should be applied in construing the words used in statutes dealing with matters relating to the public in general. In short, if an "Act is directed to dealings with matters affecting everybody generally, the words used have the meaning attached to them in the common and ordinary use of language." (Vide- Unwin v. Hanson [1891] 2 QB 115, per Lord Esher M. R. at page 119)".

[17] Lord Easter in *Unwin v. Hanson* (supra) has further explained the manner in which the words used in statutes dealing with matters relating to the public in general, are construed at page 119 as follows:

> *"If the Act, is one passed with reference to a particular trade, business, or transaction, and words are used which everybody conversant with that trade, business, or transaction, knows and understands to have a particular meaning in it, then the words are to be construed as having that particular meaning, though it may differ from the common or ordinary meaning of the words".*

[18] In *Secretary, Madras Gymkhana Club Employees' Union v. Management of the Gymkhana Club* (1968 SCR (1) 742), the Indian Supreme Court held that though "undertaking" is a word of large import, it means anything undertaken or any project or enterprise, in the context in which it occurs, it must be read as meaning an undertaking analogous to trade or business or as part of trade or business or as an undertaking analogous to trade or business (Para 37).

[19] The ECJ in *Klaus Hofner and Fritz Elser v. Macrotron GmblH,* Case C-41/90 decided on 23.04.1991 sought to maximise the application of competition law by taking a broad definition of "undertakings". The traditional definition in *Klaus Hofner and Fritz Elser v. Macrotron GmblH* (supra) at paragraph 21 was that the concept of undertaking "encompasses every entity engaged in an economic activity, regardless of the legal status of the entity and the way in which it is financed and secondly, that employment procurement is an economic activity". At paragraph 24, it was observed that "an entity such as a public employment agency engaged in the business of employment may be classified as an undertaking for the purpose of applying the Community Competition rules".

[20] In *Polychrome Electrical Industries (Pvt) Ltd v. Commissioner General of Inland Revenue* (supra), this Court held that (i) the undertaking can be broadly described as any entity in a business or trade activity taken as a whole, but does not include individual assets or liability or any combination thereof not constituting a business activity; (ii) the term "business" can thus be understood as having a broad meaning and the scope of the term extends to a trade, profession, vocation, or any such arrangement having the characteristics of a business transaction. It held at paragraph 67 as follows:

“67. The Court’s general approach to whether a given entity is an undertaking within the meaning of the tax rules focuses on the types of composite business or trade activities engaged in by such entity as a whole from which profits and income arise rather than individual business or trading activity or the characteristics of the actors who perform it. Thus, the concept of undertaking refers to the collective reference to a number of business or trading activities as a whole, undertaken by an economically independent and self-sustaining one indivisible business entity rather than a single business activity under one undertaking”.

Is an individual entitled to a concessionary rate of tax referred to in Item 31 of the Inland Revenue Act?

[21] Applying the above legal principles, I desire to consider the next question, whether the concessionary rate of tax referred to in Item 31 applies only to a company as submitted by the learned Senior State Counsel. Construing this word “business”, the Indian Supreme Court in *Narain Swadeshi Weaving Mills v. Commissioner of Excess Profits Tax* [1954] 26 ITR 765 (SC) has observed that “the word “business” connotes some real, substantial and systematic or organised course of activity or conduct with a set purpose”. Endorsing this construction, the Supreme Court in a later decision in *Mazagaon Dock Ltd. v. Commissioner of Income Tax* (1958) 34 ITR 368 has observed at page 376: “The word “business” is, as has often been said, one of wide import and in fiscal statutes, it must be construed in a broader rather than a restricted sense”.

[22] The word “business” has been narrowly defined in Section 217 of the Inland Revenue Act of 2006. It reads as follows:

*“Business” **includes** an agricultural undertaking, the racing of horses, the letting or leasing of any premises, **including** any land by **a company and the forestry**”.*

[23] The definition of “business” in Section 217 is inclusive and not exhaustive in nature and thus, it includes an agricultural undertaking, the racing of horses, the letting or leasing of any premises, including any land by a company and the forestry. As noted, the concept of “undertaking” is wider than the mere term “business” referred to in Section 217. It encompasses every entity engaged in an economic activity, and it must be defined in fiscal statutes broadly. It, thus, extends to any business or trading activity of any person, several persons (associated persons), natural or legal and separate activities within the entity (*Polychrome Electrical Industries (Pvt) Ltd v. Commissioner General of Inland Revenue* (supra). It is immaterial whether the undertaking that carries out such business or trading activity is performed by any company or individual, or several persons, natural or legal persons within such entity, so long as such

individual or company also fulfils the conditions set out in Item 31 of the Inland Revenue Act.

[24] It is to be noted that the First Schedule to the Inland Revenue Act sets out the rates of income tax applicable to individuals other than any receivers, trustees, executers or liquidators, and the Second Schedule sets out the rates of income tax applicable to companies. The Fifth Schedule sets out the rates of income tax applicable, notwithstanding the rates specified in the First, Second and Third Schedules. The Second Column of Item 31 of the Fifth Schedule to the Act refers both to a company and individual as follows:

> *''As per the First Schedule, but subject to a minimum of 10 per centum* ***for*** *an* ***individual*** *and 10 per centum* ***for a company****."*

[25] The Sinhala version of Item No. 31 also reads as follows

> පළමුවන උපලේඛනය ප්‍රකාරව, එහෙත් පුද්ගලයෙකු සම්බන්ධයෙන් සියයට 10 උපරිමයකට සහ සමාගමක් සම්බන්ධයෙන් සියයට 10...

[26] If the intention of the legislature was to limit the tax concession to a company as the Respondent argued, the reference to an "**individual"** in the Second Column of Item 31 of the Fifth Schedule to the Inland Revenue Act is meaningless. At the hearing, the learned Senior State Counsel conceded that the Sinhala version of Item 31 makes reference to an "**individual"** however, offered no explanation as to why the Second Column refers to an "**individual"** if the intention of the legislature was to limit the concession to a company. Further, Section 217 of the Inland Revenue Act, No. 10 of 2006 as amended, defines the term "person" as follows:

> *"Person" includes a company or body of persons or any government".*

[27] On the other hand, the Sinhala version of Item 31 of the Fifth Schedule to the Inland Revenue Act, as amended, refers to both profits and income of the undertaking and thus, Item 31 captures both profits and income. The Sinhala version reads as follows:

> ගබඩා කිරීමේ, මෘදුකාංග සංවර්ධනය කිරීමේ හෝ කම්කරුවන් සැපයීමේ පහසුකම් ක්‍රියාත්මක කිරීම සහ පවත්වාගෙන යෑම සඳහා ශ්‍රී ලංකාවේදි පවත්වාගෙන යනු ලබන යම් ආයතනයක් ලාබ සහ ආදායමට අදාළව ආදායම් බදු අනුප්‍රමාණය...

[28] The word "undertaking" therefore, should be understood to have been used in Item 31 in a wide sense, and must be understood as one taking in its fold all collective business or trading activities, a person or company may undertake as one economically independent and self-sustaining indivisible entity **subject to the purpose and activity** referred to in Item 31 of the Act.

[29] In my view, the concept of "undertaking" referred to in Item 31 is wider than the mere term "business" referred to in Section 217 of the Inland Revenue Act. It is not limited to the activities carried out by a company as incorrectly found by the Tax Appeals Commission. It applies both to an individual and a company and profits and income earned by an individual or company, as long as such individual or company in the nature of an undertaking carried on business or trading activities as a whole, from which profits and income arise **for the purpose and activity referred to in Item 31 of the Fifth Schedule** to the Inland Revenue Act.

Business income vs. rental income

[30] But, the determination of Tax Appeals Commission did not rest there. The Tax Appeals Commission has proceeded to consider the next crucial question whether the Appellant is involved in the activity of operating and maintaining facilities for storage. On facts, the Tax Appeals Commission has decided that the Appellant is not engaged in operating and maintaining facilities for storage as required by Item 31, but the income received by the Appellant by leasing out his premises for storage constitutes only a rental income under Section 3 (g) and not a business income. For the said reasons, the Tax Appeals Commission disallowed the tax concession sought by the Appellant under Item 31 of the Fifth Schedule to the Inland Revenue Act. The last page of the determination made by the Tax Appeals Commission at page 457 of the brief confirms this position as follows:

> *"In view of the material stated above, it is clear that the Appellant is not involved in the activity of operating and maintaining facilities for storage, but she only rents out her premises to others for storage purposes. In the circumstances, the Appellant is not entitled to claim the 10% tax concession provided in Item 31 of the Fifth Schedule to the Inland Revenue Act. Hence, we confirm the determination of the Respondent and dismiss the appeal of the Appellant."*

[31] The next question is whether the rental income received by the Appellant can be considered as a business income for the purpose of Item 31 of the Inland Revenue Act, irrespective of the fact that the concession in Item 31 applies to an individual or a company, and profits or income of an undertaking. The question whether the rental income falls into the category of business income within the meaning of Item 31 of the Fifth Schedule to the Inland Revenue Act, depends on the type of the activity that is carried on by an undertaking in Sri Lanka and the purpose referred to in Item 31 of the Act.

[32] At the hearing Dr. Shivaji Felix submitted that the Tax Appeals Commission was wrong in holding that the taxpayer must be engaged in the activity of operating and maintaining a facility for storage to be eligible for the

concessionary tax rate of 10%. He submitted that the premises in question have been constructed for the purpose of warehouses and that they are used for the sole purpose of storage facility by the Appellant. His contention was that the warehouses in question are dedicated warehouses and therefore, the Appellant is engaged in providing warehouse facilities to others for which rent was charged. Dr. Shivaji Felix submitted that if the taxpayer is operating the warehouse facility, she has to use the storage facility for herself and thus, it would not be a source of profit or income to her, but a cost to the person using the facility.

[33] The learned Senior State Counsel, however, submitted that in terms of Item 31, the concessionary rate of 10% can only be granted if the Appellant is operating and maintaining a facility for storage, but merely providing a storage facility to others and collecting a rent is insufficient for the eligibility under Item 31 of the Fifth Schedule. She referred to the lease agreements in question and disputed the position of the Appellant that the warehouses in question are dedicated warehouses as claimed by the Appellant.

[34] She further submitted that the lease agreements had imposed the liability of getting the respective premises and the goods insured on the lessees and obtaining the fire insurance policies and installing the firefighting equipment at their own cost. She submitted that no evidence has been placed by the Appellant to establish that she was operating and maintaining facilities for storage and therefore, the Appellant is not entitled to 10% concessionary rate of tax as correctly determined by the Tax Appeals Commission.

Whether the Appellant is operating and maintaining facilities for storage

[35] In order to earn the benefit under Item 31, the following conditions must be satisfied by the Appellant, namely,

(i) the Appellant is an undertaking carried on in Sri Lanka.

(ii) the Appellant being an undertaking, must have derived profits or income from storage facilities (warehouses); and

(iii) the Appellant being an undertaking, must have carried on in Sri Lanka **for operation and maintenance of facilities** for (a) storage, (b) development of software; or (c) supply of labour.

[36] It is significant to note that the words "rate of income tax applicable to any undertaking" occurring in Item 31 of the Act are qualified by the words "carried on in Sri Lanka for operation and maintenance of facilities for storage, development of software or supply of labour". In line with the meaning of the expression "undertaking" referred to in paragraph 23 of this judgment, the warehouses in question for the purpose of Item 31, should have been rented or let or leased out for activities, namely, the **operation and maintenance of**

facilities and for purposes, namely, the **storage**, **development of software** or **supply of labour** in the course of business or trade of the Appellant. If the warehouses are used for any other activity or purpose, the benefit of a concession under Item 31 of the Act would not be available to the Appellant.

[37] Dr. Shivaji Felix's argument appears to be that the expression "for operation and maintenance of facilities for storage...." must not be understood in their strict dictionary sense, because that would defeat the very purpose of encouraging persons to build warehouses for the purpose of storage. His argument is that such a strict application would result in imposing an obligation on the Appellant to use the facility for himself-not rent it out to others as a source of profit or income to her, but only a cost. According to him, the tax concession for operating storage facility was given to facilitate trade and trade activities and the expression "for operation and maintenance for facilities for storage " must take colour from the purposes for which they are expected to be rented, one of them being facilitating the trade and if the concession is limited to an undertaking, which is engaged in operating and maintaining facilities for storage, it would be impossible for the taxpayer to earn profit or income from renting such storage.

[38] Applying the principles discussed earlier, the distinction between rental income and business income must be understood in the context of the scheme, object and principles of the concession afforded under Item 31 of the Inland Revenue Act. A business income can include income from any business or trade activity carried out by a taxpayer for profit or with a reasonable expectation of profit, which may include a profession, vocation, trade, manufacturing endeavour, an undertaking of any kind, as well as a venture or concern in the nature of trade.

Beneficial provision in a tax statute

[39] It has long been a well-established principle that strict application of taxing statutes applies only to taxing provisions such as charging provision or provision imposing penalty and not to those parts of a nature of a statute which contains a machinery provision (*Indian Explosives Ltd v. Kanpur Nagar Mahapalika* (1982) All LJ 11140 & *Commissioner of Agricultural Income Tax: Calcutta v. National Tag Traders* AIR 1980 SC 301).

[40] A beneficial provision that contains a concession in rates of tax is a type of incentive provided to a taxpayer to reduce his tax liability, either by exemption, deductions and exclusions and such concessions are provided with a view to encourage and promote activities such as industrial, manufacturing, agricultural activities and development of commercial activities. Where there is a beneficial provision in a tax statute, it should be liberally construed so long as such

concession does not make violence to the plain meaning of such provision, impair the legislative requirement and the spirit of the provision.

[41] A construction of such a provision depends, *inter alia,* upon the purpose for which the concession is sought to be granted and upon the fulfilment of such conditions as may be specified therein. It is well-settled that in order to claim the benefit of a tax concession, a party who seeks such concession must comply with all the conditions of a provision and the benefit is not conferred, by stretching or adding words to the provision. In *State Level Committee v. Morgardshammar India Ltd* AIR 1966 SC 524, the Indian Supreme Court held that:

> *“..... It must be remembered that no unit has a right to claim exemption from tax as a matter of right. His right is only insofar as it is provided.... While providing for exemption, the Legislature has hedged it with certain conditions. It is not open to the Court to ignore these conditions and extend the exemption.”*

[42] It will appear from the scheme used in the Inland Revenue Act that the legislature has granted tax concessions under Item 31, with a view to encouraging an undertaking carried on business in Sri Lanka for operation and maintenance of facilities (activities) in respect of three main purposes namely, storage, development of software or supply of labour.

[43] The legislature advisedly used the words "for operation and maintenance of facilities for storage” because the intention of the legislature in granting concessionary tax rate was to encourage any undertaking to carry on business for operation and maintenance of facilities for storages or development of software or supply of labour as a source of income for such undertaking for meeting operating and maintaining costs of such warehouses.

[44] If it was the intention of the legislature to extend the benefit to profits and income derived by mere letting or renting or leasing out warehouses irrespective of whether, it was involved in operating and maintaining facilities for storage, it would not have used the words “the rate of income tax applicable to any undertaking carried on in Sri Lanka **for operation and maintenance of facilities for storage**….”. It could have easily used the words “The rate of income tax applicable to any undertaking carried on in Sri Lanka for storage….”.

[45] The key words are “for operation and maintenance of facilities for storage”, which refer to the operation and maintenance of facilities for whole storage and not that the undertaking shall also use the storage individually by itself either to store goods or provide services therefrom. I do not think that the words “for operation and maintenance of facilities for storage” used in Item 31 prevent a taxpayer from renting or leasing out his warehouses to others and making an

income or profit as submitted by Dr. Shivaji Felix. I am not impressed by the argument that it would not be possible for the Appellant to derive a profit or income by renting out his warehouses to others when the taxpayer is engaged in the business of operating and maintaining facilities for storage as referred to in Item 31 of the Inland Revenue Act.

[46] All what is intended by the legislature is that the undertaking must be engaged in the business or trading activity of operating and maintaining facilities for storage and Item 31 does not in any way, prevent such undertaking from deriving profits or income by letting or renting or leasing out warehouses to others while operating and maintaining facilities for storage.

[47] If the argument advanced by Dr. Shivaji Felix holds water, the words in Item 31 "**for operation and maintenance of facilities for storage**" will be meaningless. What will happen, if the benefit is extended to "mere provision of storage without fulfilling the condition of "operation and maintenance of facilities for storage", referred to in Item 31? If the words "operation and maintenance of facilities for storage", are not given their natural meaning, it will defeat the legislative intent and enlarge the legislative intent by disregarding a condition precedent to the operation of the concessionary tax rate in Item 31.

[48] In my view, the legislative intent was to encourage a taxpayer to carry on the business of operating and maintaining facilities for storage as an undertaking, and derive business income from such storage facilities in the course of its business or trading activity while providing storage facilities to those who are otherwise unable to afford storage facilities for themselves.

Whether the Income received from warehouses can be treated as business income

[49] The next question is to consider whether, the rental income derived by the Appellant from warehouses can be treated as a business income in the circumstances of the case. One should first determine whether the rents are income from a business of the Appellant as an undertaking and if so, whether the concession will be applicable under Item 31. A distinction has to be made between the income received by any individual from merely renting or letting or leasing out a warehousing facility and income received by any individual in the nature of an undertaking from operating and maintaining facilities for storage in the course of its business or trading activity. The former may involve the costs of constructions and other ancillary expenses while the latter involves not only costs of construction, but also operation and maintenance costs of storage facilities, such as cooling, lighting, water, cleaning, security, depreciation, repair, staircase, insurance, forklift trucks and staff and personnel costs and services.

[50] The general rule is that the income received from mere renting out of properties is a common type of rental income and not business income unless such income was received in the course of carrying on business of renting out such property where the acquisition, use, management or disposition of such property makes up an integral part of one's business operations.

[51] Dr. Shivaji Felix however, submitted that the rental income received by a company or individual is treated as business income by operation of law. Referring to two UK decisions, he submitted that prior to the statutory clarification, traditionally, the renting of premises was not considered to be a business income but it was considered as investment income (*Salisbury House Estate Ltd v. Fry* (1930) 15 TC 266*)* or a receipt arising from the ownership of property (*Griffiths v. Jakson* (1983) STC 184. (See also- consolidated written submissions at paragraphs 44-45). In *Griffiths v. Jakson* (supra), Vinelott J. quoted with approval the dictum of Lord McMillen in *Fry (Inspector of Taxes) v. Salisbury House Estate Ltd* (1930) AC 432 at 468 that "it is a cardinal principle of UK tax law that income derived from the exercise of property rights by the owner of land is not income derived from the carrying on of a trade".

[52] Dr. Shivaji Felix however, submitted that there was scope in certain contexts to treat rental income as business income and cited the following opinion of Lord Diplock in *American Leaf Blending Co. Sdn v. Director-General of Inland Revenue* (1978) STC 561, at p. 564 in support of his contention:

> *"So, it is clear that 'rents', despite the fact that they are referred to in para (d) of s. 4, may nevertheless constitute income from a source consisting of a business if they are receivable in the course of carrying on a business of pursuing the taxpayer's property to profitable use by letting it out for rent".*

[53] A perusal of the said decision reveals that Lord Diplock by applying the decision in *Commissioner of Income Tax v. Hanover Agencies Ltd. [1967] 1 A.C. 681* P.C. has held that:

1. The five paragraphs in section 4 of the Income Tax Act 1967 specifying the five classes of income in respect of which tax was chargeable under the Act were not mutually exclusive, so that "rents", despite being referred to in paragraph (d), could constitute income from a business source under paragraph (a); that, where premises were let in the course of carrying on the business of putting them to a profitable use, section 43 (1) gave primacy to the classification of the rents receivable as income from a source consisting of a business notwithstanding that they might also be classified as "rents" (post, p. 683C-E);

2. Where a company had been incorporated for the purpose of making profits, any gainful use to which it put its assets prima facie amounted to the carrying on of a business; that, although the fact that the letting of its premises was included in the objects of the company was not conclusive in deciding that the company was carrying on a business, since the only conclusion of fact which any reasonable commissioners could have reached on the evidence was that the company was carrying on a business of letting its premises for rent, it was unnecessary to remit the case for further consideration and the order of the High Court should be restored (post, pp. 683E-H, 684C, F-H).

[54] Lord Diplock referring to an "individual" however, distinguished the criteria to be applicable to a "company" from an "individual" and stated:

> *"In the case of a private individual, it may well be that the mere receipt of rents from property that he owns raises no presumption that he is carrying on a business. In contrast, in their Lordships' view, in the case of a company incorporated for the purpose of making profits for its shareholders any gainful use to which it puts any of its assets prima facie amounts to the carrying on of a business. Where the gainful use to which a company's property is put is letting it out for rent, their Lordships do not find it easy to envisage circumstances that are likely to arise in practice which would displace the prima facie inference that in doing so it was carrying on a business".* (p. 684).

[55] Dr. Shivaji Felix concedes that the question as to whether any rental income received by the Appellant could be regarded as business income within the contemplation of Section 3 (a) of the Inland Revenue Act is a question of fact (Vide- paragraph 48 of the consolidated written submissions). On examination of the above-mentioned decision, I however find that the statement of Lord Diplock referred to in paragraph 54 above, advances the case of the Respondent rather than furthering the case of the Appellant.

Factors used in distinguishing rental income from business Income

[56] In order to determine whether, the taxpayer is carrying on a business or merely earning rental income by letting out premises, the dividing line is to identify the nature of the activity and its dealings with the property. Now, I proceed to consider the Indian case law that has addressed the distinction between the rental income and the business income from warehouse facilities provided to others by taxpayers.

[57] In the case of *CIT v. Calcutta National Bank Ltd.* (1959 AIR 928), the Indian Supreme Court held that the realisation of rental income by the assessee was in the course of its business in the prosecution of one of its objects in its memorandum and was liable to be included in its business profits and was

assessable to tax as a business profit. In the Indian Supreme Court case of *Universal Plast Ltd. v. Commissioner of Income Tax,* decided on 23 March, 1999, it was decided that where the assessee is engaged in the business of giving cotton, stopped its business and let out godowns and also separated machinery and let out pressing factory to a metal pressing factory, rental income derived therefrom could not be assessed as business income.

[58] In *East India Housing and Land Development Trust Ltd v. Commissioner of Income Tax, West Bengal* (1961) 42 ITR 49, the question arose for consideration, whether the rental income that is received was to be treated as income from the house property or the income from the business. The Court took the view that the income derived by the company from shops and stalls is income received from the property and such income shall be treated as income from the house property and not income from a business (paragraph 3). The Court based its decision in the context of the main objective of the company and took the view that letting out of the property was not the object of the company at all. The Court was of the opinion that the character of that income which was from the house property had not altered because it was received by the company formed with the object of developing and setting up properties. J.C. Shah, J. stated at paragraph 6:

> *"6. The income received by the appellant from shops is indisputable income from property; so is the income from stalls from occupants. The character of the income is not altered merely because some stalls remain occupied by the same occupants and the remaining source of income from the stalls is occupation of the stalls, and it is a matter of little moment that the occupation which is the source of the income is temporary. The income-tax authorities were, in our judgment, right in holding that the income received by the appellant was assessable under section 9 of the Income Ttax Act".*

[59] In *Karanpura Development Co. Ltd. v. Commissioner of Income Tax, West Bengal,* 44 ITR 362 (SC), the Court took the view at paragraph 13 that "*the deciding factor is not the ownership of land or leases, but the nature of the activity of the assessee and the nature of the operations in relation to them. The objects of the company must also be kept in view to interpret the activity*" [emphasis added]. The position in law, ultimately, was summarised by M. Hidayatullah, J. in the following words:

> *"34. As has been already pointed out in connection with the other two cases where there is a letting out of premises and collection of rents the assessment on a property basis may be correct but not so, where the letting or sub-letting is part of a trading operation. The dividing line is difficult to find; but in the case of a company with its professed objects and the manner of its activities and the nature of its dealings with its*

property, it is possible to say on which side the operations fall and to what head the income is to be assigned.

35. Ownership of property and leasing it out may be done as a part of business, or it may be done as landowner. Whether it is the one or the other must necessarily depend upon the object with which the Act is done. It is not that no company can own property and enjoy it as property, whether by itself or by giving the use of it to another on rent. Where this happens, the appropriate head to apply is "income from property" (section 9), even though the company may be doing extensive business otherwise. But a company formed with the specific object of acquiring properties not with the view to leasing them as property, but to selling them or turning them to account even by way of leasing them out as an integral part of its business cannot be said to treat them as landowner but as trader".

[60] After applying the aforesaid principle to the facts, the Court found that (i) the sub-leases were granted, because the assessee company wanted, was a matter of business, to turn its rights to account by opening out, and developing the areas, and then granting these sub-leases with an eye to profit; (ii) the assessee company having secured a large tract of coal-bearing land parcel, developed it into a kind of stock-in-trade to be profitably dealt with, extended its business acquiring fresh fields. In the circumstances, the Court came to the conclusion that the nature of the business was trading within the objects of the company and not enjoyment of property as land owner and thus, that income had to be treated as income from business and not as income from house property.

[61] In *Atma Ram Properties (P) Ltd. v. CIT (2006)* 102 TTJ Delhi 345, the Indian Supreme Court held that rental income derived by the assessee company by letting out a property simplicitor, was chargeable to tax under the head "income from house property" and not as business income, irrespective of the fact that the assessee company was doing business of acquiring, developing and selling properties as the rental income was received by it because of ownership of the property and not by exploitation of property by way of complex commercial activity. While holding that the rental income received by the assessee does not become income from trade or business, Jagtap, A.M. J. held:

"*25. ...., the legal position which emerges can be summarised as follows. If in the given case, the assessee is found to be the owner property and rental ITA No. 273/D/2013 & 1134/D/2013 Asstt. Years: 2006-07 & 2005-06 income is earned by him by letting out predominantly the said property, such rental income will be assessable under the head "Income from house property" and not "Profits and gains of business or profession". What is let out should be predominantly the said property inasmuch as the*

rental income should be from the bare letting of the tenements or from letting accompanied by incidental services or facilities".

[62] It is not in dispute that the Appellant is doing business under the name and style of "Catherine Tradings" and receiving rental income from leasing out her premises to various companies. There is nothing to indicate in the brief that the Appellant has produced a Certificate of Business which sets out that she is engaged in the business of operating and maintaining facilities for storage as part of her business activities for the assessment years **2011/2012 and 2012/2013**.

[63] The copy of the Certificate of Registration of an Individual Business at page 456 of the brief however, reveals that the Appellant has made an application seeking **to change the Certificate of Registration of an Individual Business** on **08.05.2013** and pursuant to a statement of change dated **08.05.2013** furnished under Section 7 of the Business Names Ordinance (Chapter 149), the Certificate of Registration of an Individual Business had been issued by the Provincial Registrar of Companies of the Western Province on **08.05.2013**. It includes several business activities of the Appellant as the general nature of her business with effect from **08.05.2013**. As no Certificate of Registration of an Individual Business is available for the assessment years **2012/2012 and 2012/2013**, there is nothing to indicate that the Appellant has registered his business for the operation and maintenance of facilities for storage and received income from her predominant business activity of renting out her premises **during the relevant assessment years.**

[64] Dr. Shivaji Felix, however, submitted that the liability to pay income tax is not dependent upon having a business registration certificate and for the purpose of qualifying for the tax concession, what matters is whether the Appellant is engaged in providing warehouse facilities. The Indian Supreme Court in *Sultan Brothers (P) Ltd. v. CIT* (1964) 51 ITR 353 (SC)/ 1964 AIR 1389, 1964 SCR (5) 807, held that (i) merely an entry in the object clause showing a particular object would not be the determinative factor to arrive at conclusion whether the income is to be treated as income from business; and (ii) such a question would depend upon the circumstances of each case to decide whether the letting was the doing of a business or the exploitation of his property. Sarkar, J. held at paragraph 9:

> *"We think each case has to be looked at from a businessman's point of view to find out whether the letting was the doing of a business or the exploitation of his property by an owner. We do not further think that a thing can by its very nature be a commercial asset. A commercial asset is only an asset used in a business and nothing else, and business may be carried on with practically all things. Therefore, it is not possible to say that a particular activity is business because it is concerned with an asset with which trade is commonly carried on. We find nothing in the*

cases referred, to support the proposition that certain assets are commercial assets in their very nature".

[65] Dr. Shivaji Felix is correct in saying that the ownership of land or lease is not the sole criteria in deciding whether the rent received from warehouses is business income or rental income as observed by the Indian Supreme Court in *Karanpura Development Co. Ltd. v. Commissioner of Income Tax, West Bengal* (supra) *and Sultan Brothers (P) Ltd. v. CIT* (supra). But I am not inclined to agree with his view, as noted previously, that all that the Appellant has to satisfy is that he was merely engaged in providing warehouse facilities to be eligible for tax concession under Item 31 of the Inland Revenue Act. The absence of any reference in the business registration certificate to the renting out one's properties may not be the sole test, but it is one of the factors to be considered in identifying the nature of business activity of the Appellant and deciding whether the Appellant was carrying on a business or trade for the operation and maintenance of facilities for storage as an undertaking.

[66] While the objects of the business must be kept in mind in deciding the factors, the nature of the activity and the nature of the operations of the taxpayer in relation to them are the vital factors in deciding whether the income from warehouses could become a rental income or business income (*Karanpura Development Co. Ltd. v. Commissioner of Income Tax, West Bengal* (supra). The Indian judgments have given a demarcation line by providing a proposition that where the main object of the company is to acquire and hold properties and to let out those properties, then the rental income may be treated as income from business and not as income from house property. The question whether an income of an individual is to be treated as income from business or mere rental income **depends upon the particular circumstances of each case** as held in *Karanpura Development Co. Ltd. v. Commissioner of Income Tax, West Bengal'* (supra) and *Sultan Brothers (P) Ltd. v. CIT* (supra).

[67] In the light of above judicial pronouncements, it is significant to consider the facts and circumstances of the present case and examine first, whether the nature and the activity of the Appellant was such that she was carrying on 'business of operating and maintaining facilities for storage and second, if so, whether the income derived from leasing out her warehouses could be treated as business income of the Appellant in the course of her business of operating and maintaining facilities for storage.

[68] The Appellant has leased out her premises to several companies such as (i) Associated Motorways PLC (pp. 380, 363, 295,277,259,241), K.A.G. Associates (Pvt) Ltd (p. 345), Auto Grill Lanka Ltd (pp. 332,314,222), Distillers Company of Sri Lanka (p.332), Tyre Lanka Trading (Pvt) Ltd (p. 200) and Ranjans Ceramic (Pvt) Ltd (p. 187).

[69] From the details furnished in the brief, it appeared that apart from constructing a building to be used as a warehouse facility and leasing them out to several companies subject to common terms and conditions set out in any lease agreement, no material has been placed by the Appellant to show that she has installed plant and machinery such as central air-conditioning, overhead cranes, material handling facilities, fire-fighting equipment and fire appliances and provided specific services in the premises leased out to her lessees.

[70] A perusal of the lease agreements contained in the brief reveals that there had been no central air conditioning provided to each store and the users are responsible for the installation of their own air conditioners and other electrical appliances, firefighting equipment, fire appliances and maintaining and servicing of such equipment. Further, the employment of day and night security services for the safety of their own goods at their premises and insuring their own goods on the premises in question are the sole responsibilities of the lessees (Vide- lease agreements at pp. 173-380 of the brief).

[71] The rent receipts (pp. 108-169) are for leasing out the premises and the 10% service charge only includes basic ancillary services such as water, electricity and other, provided by the Appellant to her lessees. Apart from the total monthly rental fee which includes N.B.T., VAT and the 10% service fee for water, electricity and other, no specific facilities and amenities are provided by the Appellant to his lessees within the warehouses.

[72] A warehouse operation may cover several important operations such as developing warehouse infrastructure, operating services and customer safety measures etc. A storage maintenance may also include the upkeeping and repairing services provided for storage facilities such as storage hardware, replacement of storage components, engineering and technical resources and services either through directly without third party or through third party maintenance contracts.

[73] Had these facilities been provided, the Appellant would have employed a considerable workforce, both skilled and semi-skilled staff to whom salaries are to be paid regularly. No material has been placed by the Appellant that she carried on an organised activity with a view to commercially exploiting the infrastructure developed at a substantial cost, so that it could be treated as an undertaking engaged in operating and maintaining facilities for storage as specified in Item 31. No proof has been placed by the Appellant to come to such a conclusion as clearly observed by the Tax Appeals Commission.

[74] The legislature has been careful enough to introduce in Item 31 itself, a clarification by using the words “for operation and maintenance of facilities for storages”. If the letting out of a warehouse is only for storage purpose while not

engaging in operation and maintenance of facilities for storage as an undertaking, the question of concession under Item 31 would not arise.

[75] These observations do support the contention of the learned Senior State Counsel that the expression "for operation and maintenance of facilities for storage" would suggest that in order to earn the benefit of tax concession under Item 31, the Appellant must show that she was engaged in the operation and maintenance of facilities for storage and that she derived income predominantly from leasing out her premises in the course of business or trading activities. It is only after the Appellant has succeeded in establishing those elements that she would be entitled to the concession provided in Item 31.

[76] In *Griffiths v. Jakson* (supra), Vinelott J. quoted with approval the following dictum of Lord Greene MR in *Croft (Inspector of Taxes) v. Sywell Airdrome Ltd* (1942) 1 K.B. 317 at 329 when drawing the distinction between income derived from the exploitation of property rights and income derived from the carrying on of a trade:

> *"…why and on what principle is a person who, for example, sets up a refreshment stall on his land and provides services for people admitted to his land, not exhaustively taxed under Schedule A or B (as the case may be) in respect of or occupation save in the sense and to the limited extent that he must own or occupy the land before he can erect and carry on the refreshment stall or perform the services. The profits earned in such a case are referable, not to the exercise of the rights of property or of occupation since the customers come on to the land for the purpose of obtaining refreshment or procuring the benefit of the services. If on the other hand, the owner of land having (let me suppose) a remarkable view or some historic monument merely allows the public to come on to the land in return for an admission fee, I cannot myself see why it should be said that his profits are not covered by the Schedule A assessment since all that he is doing is to exploit his right of property by grating licences to come upon the land. The fact that he keeps the paths in order or the monument in repair in order to make a visit more attractive to the public again appears to me to make no difference, any more than does the action of the landlord of a house in keeping it in repair."*

[77] Having considered the relevant authorities, Vinelott J. concluded as follows:

> *"When the income derived by the owner from letting furnished, whether for a short or a long term and whether in small or large units and whether in self-contained units or to tenants who share a bathroom or kitchen or the like, is not income derived from carrying on a trade but is still taxable under Sch. A or, in the case of para. 4, under Case VI of Sch. D. Of course, if the owner provides services and the services are separately charged or the receipts can be otherwise apportioned in part to the provision of the services any profit derived from the provision of the services will be taxable as the profits of a trade."*

[78] The Appellant has not placed any credible material to satisfy that the nature of the leasing out her premises is an integral part of the business or trading operation of the Appellant who is engaged in operating and maintaining facilities for storage and not enjoyment of property as the land owner by merely leasing out her premises to others. The mere fact that the Appellant has leased out her premises to her lessees and derived a rental income from warehouses cannot, for that sole reason be treated, as carrying on a trade or business as an undertaking referred to in Item 31.

[79] The facts and the circumstances clearly indicate that it is a case of a leasing out the property owned by the Appellant and deriving rental income from the subject premises simplicitor as indicated in the lease agreements. It is not a case of exploitation of the property predominantly for carrying on a trade or business by an undertaking and deriving income from carrying on a trade or business for the operation and maintenance of facilities for storage.

[80] As such, considering all the facts and circumstances of the case and keeping in view the legal position emanating from various judicial pronouncements discussed hereinabove, I hold that the income received by the Appellant from leasing out her warehouses in the year under consideration cannot be treated as a business income but only as a rental income as correctly determined by the Tax Appeals Commission.

[81] For those reasons, the income received by the Appellant from leasing out her properties would fall under Section 3 (g) of the Inland Revenue Act as rental income and therefore, the Appellant is not entitled to the tax concession under Item 31 of the Fifth Schedule to the Inland Revenue Act as correctly determined by the Tax Appeals Commission.

Question of Law No. 3

The Entitlement of the Appellant to claim Interest paid with regard to the Overdraft as permissible deductions in terms of Section 25 of the Inland Revenue Act, or in the alternative, as a deduction under Section 32 (5) of the Inland Revenue Act?

[82] The Appellant has claimed interest paid in respect of loans and overdrafts taken from banks as permissible deductions in terms of Section 25 of the Inland Revenue Act, No. 10 of 2006 as amended, or in the alternative, under and in terms of Section 32 (5) of the said Act. At the hearing, Dr. Shivaji Felix submitted that the Appellant has already provided sufficient evidence to the Respondent, but the Respondent has erroneously disallowed interest paid on overdrafts paid to the bank.

[83] The assessor has permitted interest paid on loans taken for construction of buildings, but disallowed interest paid on overdrafts due to the absence of documentary proof. The Tax Appeals Commission too approached the matter on the basis that no proof was presented by the Appellant that she paid interest on overdrafts and thus, the Appellant was not qualified for the exemption under Section 32 (5). The determination of the Tax Appeals Commission at page 457 of the brief is as follows:

> *"In this case, the Appellant has claimed interest paid on loans and overdrafts taken from banks in terms of Section 32 of the Inland Revenue Act. Interests paid on loans have been allowed under Section 32 (5) of the Inland Revenue Act on an agreement basis that is Rs. 213,196/- for the year of assessment 2011/2012 and Rs. 879,645/- for the year of assessment 2012/13. However, the interest paid on overdraft facilities was not allowed for want of proof".*

[84] Subject to the provisions of subsections (2) and (4), Section 25 of the Inland Revenue Act allows deductions in ascertaining profits and income of any person from any source, all outgoings and expenses incurred by such person in the production thereof. Sub-section (f) of Section 25 (1) allows deduction of interest paid or payable by such person. Section 32 (5) of the Inland Revenue Act makes provisions for deductions in ascertaining of assessable income of a person (other than a company). It reads as follows:

> *"(5) There shall be deducted from the total statutory income of a person for any year of assessment– (a) sums paid by such person for any year of assessment by way of annuity or interest not deductible under section 25. For the purposes of this paragraph, interest does not include the excess referred to in paragraph (x) or paragraph (y) of subsection (1) of section 26:*
>
> *Provided that–*
>
> *(i) no deduction shall be allowed in respect of any such sum paid, unless the Assessor or Assistant Commissioner is satisfied that the recipient of such payment has issued a valid receipt for such payment, containing name, address and the income tax file number (if any) of such person in Sri Lanka or that the tax has been deducted under this Act before or at the time such payment is made;*
>
> ....

[85] It is settled law that tax exemption should be interpreted strictly and the burden of proving the applicability would be on the assessee to show that his case comes within the parameters of the exemption (*Commissioner of Customs v. Dilip Kumar & Co.* ((2018) 9 SCC 1). Rejecting the view expressed in *Sun Export Corporation v. Collector of Customs* 1997 (6) SCC 564 that an ambiguity in a tax exemption provision must be interpreted so as to favour the

assessee claiming the benefit of such exemption, the Indian Supreme Court held in *Commissioner of Customs v. Dilip Kumar & Co.* (supra) that:

> *"66.1. Exemption notification should be interpreted strictly; the burden of proving applicability would be on the Assessee to show that his case comes within the parameters of the exemption Clause or exemption notification.*
>
> *66.2. When there is ambiguity in exemption notification which is subject to strict interpretation, the benefit of such ambiguity cannot be claimed by the subject/Assessee and it must be interpreted in favour of the Revenue".*

[86] Section 101 of the Evidence Ordinance deals with "Burden of proof" and it reads:

> *"Whoever desires any Court to give judgment as to any legal right or liability depends on the existence of facts which, he asserts, must prove that those facts exist.*
>
> *When a person is bounded to prove the existence of any fact, it is said that the burden of proof lies on that person."*

[87] It is settled law that the burden of proof on an appeal to the commissioners against an assertion made by the Revenue is on the taxpayer to show that the assessment was not justified (*T Haythornthwaite & Sons v Kelly 11 T.C. 657).*

[88] By letter dated 19.09.2014, the Appellant has informed the Respondent that (i) she paid interest on the loan to Sampath Bank in a sum of Rs. 879,644.57 and overdrafts in a sum of Rs. 181,912.74 and (ii) she is enclosing a copy of confirmation for interest paid to Sampath Bank in a sum of Rs. 879,644.57 (Vide- page 487 of the brief). However, she has stated that she requested for confirmation of interest paid on overdrafts and the same would be forwarded to the Respondent shortly (Vide- p. 487). There is nothing on record, however, to indicate that the Appellant has paid any interest on overdrafts to Sampath Bank as she has not produced any letter from Sampath Bank confirming any such payment.

[89] For those reasons, the assessor who was not satisfied with the Appellant's claim on overdraft interest paid by the Appellant, disallowed interest paid on overdrafts in the absence of any confirmation by Sampath Bank that the Appellant has paid interest on overdrafts as claimed by her.

[90] Interestingly, Dr. Shivaji Felix invited us to remit the case to the Tax Appeals Commission under Section 9 (1) of the Tax Appeals Commission Act with a direction to permit the deduction of overdraft interest, if the required proof of same is submitted to the Commission as Section 9 (7) of the Tax Appeals

Commission Act, No. 23 of 2011empowers the Commission to summon any official of the bank or obtain written confirmation of such overdraft interest.

[91] This appeal to the Court of Appeal against the determination by the Tax Appeals Commission is by way of case stated and relates only to a point of law. In general, further evidence could not be admissible on the appeal, but, there is little doubt that the new evidence would be admitted on appeal to the Court of Appeal on the fulfilment of certain conditions *(Ladd v. Marshall [1954] 1 W.L.R. 1489).* According to "*Ladd v. Marshall*" test, to justify the reception of fresh evidence or a new trial, three conditions must be fulfilled: (a) it must be shown that the evidence could not, with reasonable diligence have been obtained for use at the trial; (b) the evidence must be such that, if given, it would probably have an important influence on the result of the case, though it need not be decisive; (c) the evidence must be such as presumably to be believed, or, in other words, it must be apparently credible, though it need not be incontrovertible.

[92] To admit fresh evidence by way of written confirmation of overdraft interest said to have been paid by the Appellant to Sampath Bank, some good reason must be shown why the Appellant in the first instance, with reasonable diligence, could not have produced, the written confirmation of the Sampath Bank either before the assessor or the Commissioner General of Inland Revenue. The Appellant has failed to satisfy this first condition laid down in "*Ladd v. Marshall*".

[93] The application to remit the case to the Tax Appeals Commission with a direction to call for the confirmation of the interest paid on overdrafts is a question of fact. Where an Appellant has failed to place sufficient evidence before the assessor or the Commissioner General of Inland Revenue to obtain a finding in her favour on a question of fact, he cannot ask the Court to remit the case to the Tax Appeals Commission to give her an opportunity to produce further evidence of the same fact (*McLaish v. CIR* 38 TC 1).

[94] In addition to the "*Ladd v. Marshall* "test, there are other factors upon which the Court is entitled to remit a case to the Commission with a direction to revise the assessment in accordance with the opinion of the Court. Where there is evidence of fraud, or conspiracy, or deception, or misdirection and any judgment was procured by any party in his favour by fraud (*Meek v. Fleming [1961] 2 Q.B. 366* , p. 379), it would be wrong to allow him to retain the judgment unfairly procured.

[95] The justification for remitting the case for Commissioners would include (i) misdirection on the part of the Commissioners and the Commission was deliberately misled by the parties in a material particular (*John Anthony Brady*

(Her Majesty's Inspector of Taxes) v. Group Lotus Car Companies Plc Lotus Cars Limited (1987 WL 493342) & *Be Lasala v. De Lasala* [1980] A.C. 546, 561); (ii) the Commissioners failed to adopt the correct legal approach to the assessment of the evidence brought before them (*John Anthony Brady (Her Majesty's Inspector of Taxes) v. Group Lotus Car Companies Plc Lotus Cars Limited* (supra). In such situations, the appropriate remedy would be for the Commissioners to re-assess on the correct basis, the evidence which was before them when they made their mistake of law.

[96] The present case is not a *fortiori* to the justification of remitting the case to the Tax Appeals Commission directing it to allow fresh evidence by way of confirmation of overdraft interest for the purpose of deduction under Section 32 (5) or 25, which does not satisfy the requirements of *Ladd v. Marshall* (supra) and the principles of law noted in paragraphs 91, 94 and 95 of this judgment.

[97] For those reasons, I am not inclined to remit the case to the Tax Appeals Commission to revise the assessment based on future proof of overdraft interest being submitted by the Appellant as invited by Dr. Shivaji Felix. For those reasons, I hold that the Appellant is not entitled to claim deductions on the interest on overdrafts under Section 25 or Section 32 (5) of the Inland Revenue Act, No. 10 of 2006 as amended, as correctly determined by the Tax Appeals Commission.

Question of Law No. 4

Whether, on the facts and circumstances of the case, the Tax Appeals Commission erred in law in coming to the conclusion that it did in dismissing the Appeal.

[98] At the hearing Dr. Shivaji Felix invited us to hold that the Tax Appeals Commission has failed to consider the alternative possibility of whether the Appellant was entitled to be taxed at a concessionary tax rate contemplated by Section 59B of the Inland Revenue Act, No. 10 of 2006 as amended. The learned Senior State Counsel has submitted in the written submissions filed on behalf of the Respondent that the Appellant is not entitled to raise this point as she had not claimed the concession under Section 59B of the Inland Revenue Act and accordingly, a question of law not included in the case stated is not a question of law material to the determination of this case.

[99] Section 11A (1) of the Tax Appeals Commission Act, No. 23 of 2011, as amended provides that either party who is dissatisfied with the decision made by the Commission may, in writing make an application requiring the Commission to state a case on a question of law for the opinion of the Court of Appeal. The case stated by the Commission shall set out the facts, the decision of the Commission, and the amount of the tax in dispute where such amount

exceeds five thousand rupees, and the party requiring the Commission to state such case shall transmit such case, when stated and signed to the Court of Appeal, within fourteen days after receiving the same (S.11A (2)).

[100] The jurisdiction of the Court of Appeal is, however, not limited to the questions of law set out in the case stated and the Court of Appeal has the power to determine a question of law, not specifically raised at an earlier stage provided it is a question that can be decided on the facts as found by the Commission *(Kalem v. Jeffry* (1914) 3 KB 160)), *W.S. Try Ltd v. Johnson* 1946 (1) AER 531, *London County Council v. Tavern* 1956 (1) WLR 1296, *W.W.S. Fernando v. CIT* 3 Cey. TC 15). Section 11A (6) of the Tax Appeals Commission Act provides that the Court of Appeal may hear and determine any question of law arising on the stated case and may, in accordance with the decision of Court upon such question, confirm, reduce, increase or annul the assessment determined by the Commission, or may remit the case to the Commission with the opinion of the Court, thereon.

[101] We are now invited to decide the question whether, on the facts and circumstances of the case, the Appellant is entitled to the10% concessionary tax rate as contemplated by Section 59B of the Inland Revenue Act, No. 10 of 2006 as amended. Section 11A (6) requires the Court to hear and determine any question of law arising in the stated case and this involves (i) the construction of the language of the case stated and it must be interpreted in the light of common knowledge and by the common sense of the language used; and (ii) all questions that could be raised on the whole case were intended to be left open (*M.P. Silva v. Commissioner of Income Tax* Reports of Ceylon Tax Cases Vol. 1, 336).

[102] The Appellant is claiming the total rental income under Section 59B as expenses incurred in the provision of services when calculating the service income of the Appellant, despite the fact that Appellant had agreed to take the 10% of the total service fee as a profit of service sector, before the Commissioner-General who has resolved the issue. The relevant parts of the reasons for the determination of the Appeal made by the Senior Commissioner at page 23 of the TAC brief are as follows:

> *"The expenses incurred in the production of such ancillary services can be allowed as expenditure when calculating the service income. But other expenses which do not relevant to generate that service income cannot be allowed. Furthermore, as per agreement reached on 27.09.2016 with me, the Authorised Representative agreed to take 10% of the total service fee received as a profit of service sector. Agreed profit on service income is mentioned below:*
>
> *2011/12 – 614,320 x 10% = Rs. 61,432*

2012/13 – 1,07,120 x 10% = Rs. 160,712.

Hence, the issue of loss from service sector is resolved".

[103] The question whether, in addition to the 10% service fee allowed on ancillary services, the Appellant is entitled to a separate service income for providing any other services is a question of law which involves a consideration of the meaning to be attributed to the words "undertaking engaged in the provision of any service and the turnover of such undertaking ...for that year of assessment ...does not exceed three hundred million rupees".

[104] The question sought to be decided on appeal is a pure question of law which does not require the ascertainment of new facts as the facts are found in the case stated before us and are available in the brief (Vide- page 23 of the TAC brief). On the other hand, the Senior Commissioner has dealt with this matter as indicated at page 23 of the brief. The Court has before it all the requisite material for deciding that question of law which arises on the assessment determined by the Tax Appeals Commission. Thus, the determination of that new question of law will result in the confirmation, reduction, increasing or annulment of the assessment determined by the Tax Appeals Commission or remitting of the case to the Tax Appeals Commission.

[105] The Question of Law No. 5 raised by Dr. Shivaji Felix is this:

> Is the Appellant entitled to the concessionary tax rate of 10% under and in terms of Section 59B of the Inland Revenue Act, No. 10 of 2006, as amended?

[106] I shall now proceed to consider this question of law and decide whether it will result in the confirmation, reduction, increasing or annulment of the assessment determined by the Tax Appeals Commission or remitting of the case to the Tax Appeals Commission. The learned Senior State Counsel, however, submitted that the service charge of 10% referred to in lease agreements is connected to the rental income of the Appellant and thus, the income received from renting out the premises cannot be separated from the service charge when calculating the service income of any undertaking under Section 59B. She further submitted that the Appellant had agreed to take 10% of the total service fee as profit for service section and that the Appellant has failed to produce any document to prove that he had received a separate service income from the warehouses in question.

[107] Section 59B (2) of the Inland Revenue Act reads as follows:

> "For the purpose of this section "undertaking" in relation to any year of assessment means any undertaking-

(a) engaged in the manufacture of any article or in the provision of any service; and

(b) the turnover of such undertaking (other than from the sale of any capital asset) for that year of assessment-

(i) being any year of assessment commencing on or after April 1, 2001 but prior to April, 2013, does not exceed three hundred million rupees;

(ii) being any year of assessment commencing on or after April 1, 2013, does not exceed five hundred million rupees".

[108] For the eligibility for tax concession under Section 59B, the following two limbs in Section 59B (2) must be satisfied:

(c) **Any undertaking** must be **engaged in the manufacture of any article** or **in the provision of any service**; **and**

(d) the turnover of such **undertaking** (other than from the sale of any capital asset) for that year of assessment commencing on or after April, 1, 2001 but prior to April, 2013, does not exceed Rs. 300/- Million.

[109] Further, Item 33 (a) to the rate of income tax applicable to profits and income of any person from any undertaking referred to in Section 59B reads as follows:

33. The rate of income tax applicable to profits and income of any person from any **undertaking** referred to in Section 59B.

(a) for any year of assessment commencing prior to April 1, 2014	As per the First Schedule, but subject to a maximum of 10 per centum for an individual, and 10 per centum for a company

[110] The words "any undertaking engaged in the manufacture of any article or in the provision of any service" in section 59B (2) unmistakably demonstrate that the undertaking for the purpose of tax concession under section 59B must be one, which partakes of the character of a business or trade in relation to "manufacture of any article" or "provision of any service". On a plain reading, it transpires that under section 59B (2), an assessee becomes entitled to 10% tax concession of the profits and income where the **"undertaking"** is engaged in the business of manufacture of any article or in the **provision of service and** the total turnover of **such undertaking** does not exceed Rs. 300 million (prior to April 1, 2013).

[111] The concession specified in Section 59B in relation to any **undertaking** engaged in the manufacture of any article or in the provision of any service has to be understood in the context in which the term **"undertaking"** is to be understood *(Polycrome Electrical Industries (Pvt) Ltd v. Commissioner-General of Inland Revenue)* (supra)**.** The term "undertaking" has to be understood as an economically independent and self-sustaining entity taken as a whole and in the context in which it occurs and thus, it must be understood first, as any **undertaking** as a whole and then, such undertaking must be engaged in the manufacture of any article or provision of services (supra).

[112] This Court held in *Polycrome Electrical Industries (Pvt) Ltd v. Commissioner-General of Inland Revenue* (supra) that one has to consider the object of granting tax concessions to an undertaking under Section 59B and thus, the said expression "undertaking" will have to be construed liberally in a broader commercial or business/trade sense, keeping its object and context in mind.

[113] The question is, in addition to providing ancillary services referred to in the lease agreements, whether the Appellant is engaged in providing services as an integral part of her business or trading activity in the nature of an undertaking referred to in Section 59B to be regarded as a separate service income, rather than mere activity of renting out her premises to tenants for storage. As noted, the service charge of 10% referred to in the lease agreements can only be regarded as ancillary services, which constitute an insignificant portion of the whole rental income.

[114] The Appellant has not produced account statements signed by an Accountant to satisfy that she has maintained separate accounts for rental income and service income. The unsigned document at page 106 of the TAC brief only indicates that the Appellant has added the service fee charged for ancillary services to the rental income and shown the total income of the Appellant without producing any financial statement to substantiate the details set out therein. As per the document at page 106, the total income of the Appellant from the rental income and service fee for the financial year 2011/2012 was Rs. 10,452,200/- which includes the rental income of 9,937,880/- and the service fee of Rs. 614,320/-. The Respondent at page 23 of the TAC brief has granted 10% of the total service fee of Rs. 614,320 for 2011/12 (614,320 x 10% = Rs. 61,432). The Appellant has agreed to take the said 10% of the total service fee received as a profit of service sector as expenses incurred in the provision of such ancillary services (p. 23 of the TAC brief).

[115] As per the document at page 105, the total income of the Appellant from the rental income and the service fee for the financial year 2012/2013 was Rs. 17,581,200/-, which includes the rental income of 16,009,080/- and the service

fee of Rs. 1,572,120/- and the Respondent at page 23 of the TAC brief has granted 10% of the total service fee of Rs. 1,607,120 for 2012/13 (1,607,120 x 10% = Rs. 160,712). The Appellant has agreed to take the said 10% of the total service fee received as a profit of service sector as expenses incurred in the provision of such ancillary services (p. 23 of the TAC brief).

[116] It is crystal clear that the service fee referred to in the said documents (pp. 105 and 106) and the lease agreements relate to the ancillary services provided by the Appellant to her lessees. The Appellant has not produced any credible document to show that, in addition to the 10% service fee referred to in the said documents and the lease agreements, she had generated any other service income from warehousing facilities.

[117] The ancillary services provided by the Appellant as referred to in the lease agreements are directly connected to her rental income, which cannot be interpreted as services provided by the Appellant as an undertaking in the course of her business or trading activity to be treated as a separate service income within the meaning of Section 59B of the Inland Revenue Act.

[118] In *Coman v. Governors of the Rotunda Hospital,* [1921] 1 A.C.1, the House of Lords drew a clear distinction between a landowner who leases or lets his land to tenants and derives a profit from the rents from lessees and the landowner who utilises his land while retaining possession of it by hiring it out to be used by persons who do not take any estate or interest in the land itself. In the *Rotunda* case, concert and ball rooms were hired out to persons desirous of utilising them for the purposes of musical or dancing entertainments and the owners had equipped the rooms so as to make them available for those purposes.

[119] The Court held that the services which the owners had rendered could not be regarded as mere incidents attached to the letting of the rooms themselves, but an "adventure or concern in the nature of trade". Lord Atkinson, at page 35, said, 'I do not think the services thus rendered can be regarded as "mere incidents attached to the letting of the rooms themselves. What is let, paid for and used is the room plus the services as "constituting one composite whole, for which money is paid, and "is obtained from the general public. In my opinion this letting "is an "adventure or concern in the nature of trade".

[120] As noted, there is nothing to indicate in the lease agreements in specific terms that the Appellant is providing separate services, in addition to ancillary services provided to her tenants to be regarded as a separate service income. The mere fact that the Appellant is providing storage facilities with ancillary services to her lessees and collecting a profit therefrom cannot be treated as a profit of any undertaking engaged in the provision of service in the nature of business or trade within the meaning of Section 59B of the Act.

[121] Having regard to the totality of the circumstances and to the true substance of the agreements, I hold that the Appellant is not entitled to the concessionary rate of 10% under and in terms of Section 59B of the Inland Revenue Act, No. 10 of 2006 as amended.

Conclusion & Opinion of Court

[122] In these circumstances, I answer Questions of Law against the Appellant and in favour of the Respondent as follows:

1. No.
2. No.
3. No
4. No
5. No, The Appellant is not entitled to the concessionary rate of 10% under and in terms of Section 59B of the Inland Revenue Act, No. 10 of 2006 (as amended).

[123] For those reasons stated in this judgment and subject to our findings in paragraph 29 of this judgment, the final determination made by the Tax Appeals Commission dated 01.10.2019 is confirmed and the Appeal of the Appellant is dismissed.

[124] The Registrar is directed to send a certified copy of this judgment to the Tax Appeals Commission.

JUDGE OF THE COURT OF APPEAL

M. Sampath K.B. Wijeratne, J.

I agree.

JUDGE OF THE COURT OF APPEAL