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

In the matter of an appeal by way of a case stated 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).

IWS Investment (Private) Limited,
IWS Centre,
451, Kandy Road,
Kelaniya.

APPELLANT

CA No. CA/TAX/0052/2019
Tax Appeals Commission
No. TAC/IT/056/2016

v.

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

RESPONDENT

BEFORE : Dr. Ruwan Fernando J. &
M. Sampath K. B. Wijeratne J.

COUNSEL : Johann Corera for the Appellant.

Chaya Sri Nammuni, SSC with Dr. C. Ekanayake, SC for the Respondent.

WRITTEN SUBMISSIONS	:	12.02.2021 & 07.01.2022 (by the Appellant) 19.11.2021 & 19.01.2022 (by the Respondent)
ARGUED ON	:	25.11.2021
DECIDED ON	:	27.01.2022

M. Sampath K. B. Wijeratne J.

Introduction

The Appellant, IWS Investment (Private) Limited (formally Interfreight (Private) Limited), is a company incorporated in Sri Lanka, engaged in the business of construction, operation and maintenance of modern warehouse complexes, market warehouses and storage space and the management, maintenance and provision of other such facilities.

The Appellant submitted its Income Tax returns for the period of 2010/2011 and the Assessor rejected the said returns on the ground that the credit balance of Interfreight (Private) Limited and the corresponding debit balance of the Appellant company were different. Furthermore, the capital allowance claimed for the building was rejected on the ground that only a part of the building had been used for business purposes and therefore, the capital allowance claimed for the entire building could not be allowed under Section 26 (g) [precisely Section 26 (1) (g)] of the Inland Revenue Act No. 10 of 2006, as amended (hereinafter referred to as 'the Inland Revenue Act' and 'the Act').

Accordingly, the Assessor made an assessment and issued a letter of intimation dated 28th November 2013, in terms of Section 163 (3) of the Inland Revenue Act. However, when the Appellant appealed against the said assessment to the Commissioner General of Inland Revenue (hereinafter referred to as the 'CGIR'), the Respondent reduced the assessment made by the Assessor. The Respondent, in his determination dated 25th July 2016, allowed in full the depreciation allowance claim for

the building, which amounted to Rs. 4,534,990, as a deduction. However, the Respondent confirmed the assessment made by the Assessor amounting to Rs. 18,558,455, which amount has been treated by the Assessor as a credit balance lying with the Appellant company, subject to income tax. Accordingly, the Respondent reduced the tax payable by the Appellant to a sum of Rs. 4,460,605 and with the penalty of Rs. 2,230,303, the total amount payable is Rs. 6,690,908.

The Appellant appealed to the Tax Appeals Commission (hereinafter referred to as the 'TAC') in terms of Section 7 of the Tax Appeals Commission Act No. 23 of 2011, as amended (hereinafter referred to as 'the TAC Act'). The TAC, by its determination dated 10th October 2019, affirmed the determination of the CGIR and confirmed the assessment determined by the CGIR, thus dismissing the appeal.

The Appellant then moved the TAC to state a case on the following questions of law for the opinion of this Court in terms of Section 11A of the TAC Act:

1. *Has the assessor and/or Commissioner General of Inland Revenue and/or Tax Appeals Commission acted arbitrarily in the computing of the Appellant's taxable income?*
2. *Has the Commissioner General of Inland Revenue and/or the Tax Appeals Commission erred in computing of the Appellant's taxable income?*
3. *Has the Tax Appeals Commission erred and/or misdirected itself and/or acted arbitrarily in rejecting the reconciliation provided by the Appellant's auditors?*
4. *Has the Tax Appeals Commission erred in law by taking into consideration the suspicions of the Representative of the Commissioner General?*
5. *Has the Tax Appeals Commission erred in law in interpreting and/or applying the provisions of Section 103 of the Inland Revenue Act?*

Admittedly, the audited accounts of the Appellant and related parties were submitted to the Assessor as well as to the CGIR. However, the Appellant has alleged that the CGIR had failed to transmit those material documents

to the TAC in violation of Section 9 (2) of the TAC Act. Regardless of this claim, the Appellant has tendered the relevant documents to this Court along with the motion dated 24th June 2020, with the agreement of the Respondent. Although the learned Senior State Counsel reserved the right to raise objections, if any, with regard to the said motion, no objections were raised until this matter was fixed for judgment. Therefore, this Court is obliged to conclude that the Respondent does not have any objections regarding the reception and consideration of those documents.

It was argued by the learned Counsel for the Appellant that all taxes impose or create a burden on the subject and therefore, no tax, rate or levy shall be imposed except by or under the authority of a law passed by Parliament. Citing *Vallibel Lanka (Pvt) Limited v. Director General of Customs and three others*,[1] it was submitted that the intention to impose duties and/or taxes must be shown by clear and unambiguous language and cannot be inferred by ambiguous words. Also cited in support was Article 148 of the Constitution of Sri Lanka which provides that no tax, rate or any other levy shall be imposed except by or under the authority of a law passed by Parliament. The learned Counsel also cited *Maxwell on The Interpretation of Statutes*, where it is stated that:[2]

'*It is a well settled rule of law that all charges upon the subject must be imposed by clear and unambiguous language… There is no presumption as to a tax. Nothing is to be read in, nothing is to be implied*.'

Having cited the aforesaid material, the leaned Counsel for the Appellant argued that the sum which is subject to the assessment, assumed to be in the hand of the Appellant, is not taxable in terms of the Inland Revenue Act. He contended that only the '*profits or income*' as defined in the Act, derived from a source specified in the Act and calculated in accordance with the provisions of the Act can be taxed. The phrase '*profits' or 'income*' is defined in Section 217 and the sources of income subject to income tax are set out in Section 3 of the Act.

[1] [2008] 1 Sri.L.R. 219

[2] P. St. J. Langan & P. B. Maxwell, *Maxwell on The Interpretation of Statutes,* Twelfth Edition, 1969. at p.257

Accordingly, “profits” or “income” means *the net profits or income from any source for any period calculated in accordance with the provisions of this Act.*

Section 3 of the Inland Revenue Act reads thus:

> *For the purpose of this Act, "profits and income" or "profits" or "income" means-*
>
> > *(a) the profits from any trade, business, profession or vocation for however short a period carried on or exercised;*
> >
> > *(b) the profits from any employment;*
> >
> > *(c) the net annual value of any land and improvements thereon occupied by or on behalf of the owner, in so far as it is not so occupied for the purposes of a trade, business, profession or vocation;*
> >
> > *(d) the net annual value of any land and improvements thereon used rent-free by the occupier, if such net annual value is not taken into account in ascertaining profits and income under paragraphs (a), (b) or (c) of this section, or where the rent paid for such land and improvements is less than the net annual value, the excess of such net annual value over the rent to be deemed in each case the income of the occupier;*
> >
> > *(e) dividends, interest or discounts;*
> >
> > *(f) charges or annuities;*
> >
> > *(g) rents, royalties or premiums;*
> >
> > *(h) winnings from a lottery, betting or gambling;*
> >
> > *(i) in the case of a non-governmental organisation, any sum received by such organisation by way of grant, donation or contribution or any other manner; and*
> >
> > *(j) income from any other source whatsoever, not including profits of a casual and non-recurring nature.*

I do concede that in terms of Section 2 of the Act, income tax has to be charged subject to the provisions of the Act. Yet the issue in this case is whether the amount shown in the Appellant’s statement of accounts as

amounts due to related companies, under the heading of current liabilities, is genuine or fictitious.

The learned Counsel for the Appellant cited *Kanagasabhapathi v. Commissioner General of Inland Revenue*,[3] wherein it was observed that "*in tax cases it is always necessary to remind oneself that when it is sought to impose a tax on the subject, the burden is always on the revenue authorities to prove that tax is exigible*.". The learned Counsel's argument was that the CGIR had failed to demonstrate that the monies assumed to be in the hands of the Appellant were derived from one of the sources defined in Section 3 of the Act.

Further, the learned Counsel for the Appellant relied upon Section 3 (j) of the Act and argued that "*profit or income*" of a casual and non-recurring nature is excluded from the scope of the Act.

Section 3 (j) of the Act reads thus:

> *(j) income from any other source whatsoever, not including* ***profits*** *of a casual and non-recurring nature.* (emphasis added)

However, it is clear that only the *profits* of a casual and non-recurring nature are excluded as a "*profit and income*" or "*profits*" or "*income*".

Therefore, the argument of the learned Counsel for the Appellant does not hold water. Quite contrary to the above argument, it was submitted by the learned Counsel that the cash in the hands of the Appellant, borrowed from a third party in order to meet cash flow requirements, does not constitute "*profit*" or "*income*" in terms of the Act.

However, the Assessor has made the assessment in issue on the basis that the accounting entries pertaining to the Appellant's borrowings do not correspond with the lender's accounting entries.

Upon a careful consideration of the letter of intimation, it appears to me that the Assessor has offered an opportunity for the Appellant to prove the genuineness of the questionable entries in their statement of accounts. The letter of intimation dated 28th November 2013 itself states that "*During the course of audit* (sic) *company has failed to prove the genuineness of*

[3] Sri Lanka Tax Cases, Vol. IV, p.140

creditors with substantial accuracy.". There had been a further opportunity to reconcile the above-said entries when the appeal was heard before the TAC.

Moreover, the accountants for the Appellant themselves have admitted in their correspondence with the TAC (pages 82 and 83 of the brief) that there had been erroneous entries made by the accountants of other companies in the relevant statements of accounts. If such entries had been made in error (as claimed, to other companies and not to and from the Appellant company as should have been the case), then it would simply be a matter of reversing those entries by crediting to and debiting from the appropriate entities.

Therefore, even though it has had two separate opportunities to reconcile the discrepancies in its accounts, the Appellant has failed to prove the genuineness of the entries in issue to the satisfaction of the Assessor and/or the TAC. The Appellant company's tax consultants themselves, in their letter to the TAC dated 26th June 2018 (page 83 of the brief), have admitted that a difference of Rs. 626,068.46 still remained which could not be reconciled. Of course, this is not the amount in dispute according to the Assessor.

I also observe that neither of the statements of accounts submitted in order to explain the disparities in accounts (at pages 22 and 82 of the brief) have been signed by a person with authority, and therefore do not appear to be official statements. There do not appear to be any details regarding the individuals who drafted, checked or approved said statements, even if they have been sent with their respective covering letters (at pages 23 and 83 of the brief).

The Appellant's Tax Consultant has submitted to the TAC that no computation was given as to how the Assessor assessed Rs. 18,558,455 as an additional income of the company for the year of assessment 2010/2011.[4]

However, the Respondent has made it clear from the figures appearing in the letter of intimation itself that the assessment has been made in the following manner set out in the written submissions tendered by the

[4] At p.11 of the appeal to the TAC; beginning at p.17 of the appeal brief

Respondent to the TAC.[5] The same calculation is set out in the written submissions filed by the Respondent in this Court as well.

Calculation of Assessed Credit Balance Rs. 18,558,435

Balance as per Interfrieght (Pvt) Ltd as at 31.03.2011		Rs. 98,211,017
Less balance as per Interfrieght (Pvt) Ltd as at 31.03.2010		Rs. 79,647,970
Difference		Rs. 18,563,047
Balance as per IWS Holdings (Pvt) Ltd as at 31.03.2011	Rs. 28,923	
Less balance as per IWS Holdings (Pvt) Ltd as at 31.03.2010	Rs. 24,331	
Difference	Rs. 4,592	
Credit balance as per Assessment		**Rs. 18, 558, 455**

(Rs.18,563,047 – Rs.4,592 = Rs. 18, 558, 455)

Therefore, I am satisfied that the Assessor has made a sufficient disclosure of reasons for the non-acceptance of the return.

The Appellant's contention is that the burden to demonstrate that tax claimed is due (in terms of the Inland Revenue Act) is on the CGIR.[6]

In reply, the Respondent submitted that the burden is on the Appellant to establish to the satisfaction of the Assessor that the amount in issue was borrowed, and upon failure to do so, it should be treated as an income.

S. Balaratnam, in his work titled *Income Tax in Sri Lanka*, states that:[7]

'*When an Assessor, on the basis of his judgement makes an assessment, the burden of showing that such an assessment is excessive is on the taxpayer. It is for the taxpayer to substantiate that the Assessor had not made an*

[5] At pp.79-80 of the appeal brief

[6] The Appellant relied on the case of *Kanagasabhapathi v. Commissioner General of Inland Revenue, supra* note 3.

[7] S. Balaratnam, *Income Tax in Sri Lanka*, Third Edition, 2001. at pp.645-646

assessment to the best of his judgement. An Assessor is presumed to act in good faith and reasonably, in arriving at a judgement of the profits and income. Whether the Assessor has acted in good faith in the exercise of his judgement is a question of fact and generally courts will not interfere with such conclusions on questions of fact unless the conclusions arrived are at variance with facts.

The judgement of the Assessor must be based on what he honestly believes to be the proper estimate of the assessment after consideration of all factors pertaining to the case.'

He further states that:[8]

'*The challenge of an assessment made on the judgement of the Assessor must be on the basis of facts and reasonable inference that would dislodge the conclusions reached by facts or inference*.

> *"Either the cost of sales figures in the return or an alternative cost of sales figures had to be proved before the best of judgement assessment could be displaced and the company had completely failed to prove any cost of sales figures either directly or by reasonable inference."*.[9]

So long as the assessment made on the basis of judgement is properly arrived at from the facts available to an Assessor, the requirement that the assessment is properly made will be fulfilled.

> *"What the words "best of their judgement" envisage… is that the Commissioner will fairly consider all material placed before them and, on that material, come to a decision which is one which is reasonable and not arbitrary as to the amount of tax which is due. As long as there is some material on which the Commissioners can reasonably act, then they are not required to carry out investigations which may or may not result in further material being placed before them."*.[10]

[8] S. Balaratnam, *Income Tax in Sri Lanka*, Third Edition, 2001. at pp.647-649

[9] Balaratnam, citing Lord Lowry in *Bi-Flex Caribbean Ltd v Board of Inland Revenue* [1990] 63 TC 515.

[10] Balaratnam, citing Justice Woolf in *Van Boeckel v. Commissioner of Customs and Excise* [1981] STC 290.

The Assessor is entitled to reject the returns where he honestly comes to the conclusion that he should not accept the return, but he must give his reasons in writing for not accepting such return. Where the return is rejected, he can substitute a higher estimate of the profits according to his judgement and can make any random assessment.

> *"Where an assessee does not choose to submit accounts, or fails to make a true and full disclosure, or by fraud or wilful evasion endeavours to escape liability, so that the amount of his profits cannot be strictly determined, he cannot complain if a random assessment is made upon him by the Crown."*.[11]

The Burden lies on the taxpayer to disprove the correctness of the estimated assessment and to establish a lower figure. Although the areas of dispute may revolve around the reasons of the Assessor for making the assessment, the onus of disproving the estimate will be on the taxpayer.

> *"Where, owing to the unsatisfactory nature of the return made by the Assessee, the Assessor does not accept the return and makes an estimated assessment, then, the burden is on the Assessee to show what his correct income is. If he fails to do this, the estimated assessment must be accepted. There is no hardship in this rule, because an honest Assessee can easily discharge that onus by producing his correct accounts. It is the dishonest Assessee who will not be able to discharge the burden of showing that the Assessor's estimated assessment is excessive."*.'

Having comprehensively addressed the bases for assessment and the burden of proof as above, Balaratnam then states the following regarding proof of evasion of tax:[12]

'*Evasion may be proved where the understatement is found to be deliberate.*

> *"We agree with the Court of Appeal that here was evasion on the part of the appellant and that, having regard to the amount and the nature of the transaction involving the sale of the entirety of the company's fixed assets, it was not a case of mistake by the Auditors*

[11] Balaratnam, citing *Macpherson & Co. v. Moore* 6 TC 114

[12] S. Balaratnam, *Income Tax in Sri Lanka*, Third Edition, 2001. at p.657

company, who handled the tax matters. This was wilful and deliberate. The Assessor took into consideration the fact that in the return of the sister company to which those assets were transferred, the necessary adjustments were made, which resulted in a reduction of the tax liabilities of that company; the failure to make similar corresponding adjustments in respect of the appellant company, resulted in tax advantage to the appellant as well. Prima facie, therefore, the understatement of income is deliberate and not an accidental error or omission and the Assessor was justified in forming that opinion".'

E. Gooneratne states the following, in his work titled *Income Tax in Sri Lanka*:[13]

'*The account prepared for each accounting period is a summary of the entries in the books of account. The statement of account annexed to a return, or submitted later, if required, is evidence tendered to prove the correctness of the return. A rejection of the account is a rejection of the evidence relied upon by the person assessed. An assessor may give the assessee an opportunity of supporting his return by producing accounts certified by an Accountant. The opportunity he gives to an assessee to produce certified accounts is an act done in the exercise of the discretion given to him to accept or reject the return.*[14] *The rejection of the account when produced is also an act done in the exercise of the discretion given to him to accept or reject the return. He can reject accounts which he believes to be false and unreliable although there is no direct or reliable evidence to prove them incorrect.*[15] *The sufficiency of the reason given for rejecting the accounts cannot be questioned; except in the course of an appeal against the assessment. The omission of a single item of receipt from the accounts is a sufficient reason for rejecting the account if the omission cannot be explained. The intentional omission of an item entitles the assessor to conclude that the account cannot be relied upon to show the whole of the trading profit.*'[16]

[13] M. Weerasooriya and E. Gooneratne, *Income Tax In Sri Lanka*, Second Edition, 2009. at p.423

[14] Gooneratne, citing *Wall v. Cooper* 14 TC 552

[15] Gooneratne, citing *Gurmukh Singh v. CIT* AIR 1944 Lah 353; *Gange ram Balmochand v. CIT* AIR 1937 Lah 721; *Harmukhrai Dulchand In re* AIR 1928 Cal. 587.

[16] Gooneratne, citing *Rosetta Franks Ltd. v. Dick* 36 TC 100

In the instant case, the Assessor, before rejecting the return submitted by the Appellant, has given sufficient opportunity for the Appellant to rectify the defects said to have been there in the account statements. However, the Appellant has failed to reconcile those defects in an acceptable manner.

Gooneratne has stated the following regarding an Assessor's power to make use of the account statements of a third party in order to make an assessment of a taxpayer:[17]

'*An estimated assessment should not be a guess. An assessor must make an estimate of the income for the year of assessment and in preparing the estimate he must make use of the relevant data available to him. There are several sections in the Act which give him the power to obtain any information he requires for the purpose of making an estimate.* ***The data may be obtained from the file of another taxpayer****. The assessor has a right to use the data he obtained from the file of one tax payer for the purpose of estimating the income of another tax payer* (emphasis added).'

'*There is no rule of law as to the proper way of making an estimate, there is no way of making an estimate which is right or wrong in itself. It is a question of facts and figures whether the way of making an estimate in any case is the best way in that case.*'

Therefore, in my view, the Assessor has acted lawfully in obtaining information from the account statements of IWS Holdings (Pvt) Ltd, the sister company of the Appellant, in deciding to reject the return submitted by the Appellant.

On the opportunity offered by the Assessor to offer an explanation, the Appellant has submitted the intercompany reconciliation.[18] As it was correctly observed by the CGIR in his determination, said amended account statement is not certified either by the Directors of the company or by the auditors. Further, upon a comparison of the certified account statements of the Appellant and IWS Holdings (Pvt) Ltd, with the amended account statement of the Appellant, it appears to me that there are material differences, not only concerning the different companies but also with regard to the figures.

[17] M. Weerasooriya and E. Gooneratne, *Income Tax In Sri Lanka*, Second Edition, 2009. at p.424

[18] At p.22 of the appeal brief.

Hence, it is obvious that the discrepancies have not occurred simply by the then accountants of the company making erroneous entries to other companies, instead of debiting and crediting the accounts of IWS Holdings (Pvt) Ltd, as stated by the Appellant.[19]

Therefore, in my view the TAC has not erred and/or misdirected itself and/or acted arbitrarily in rejecting the reconciliation provided by the Appellant's auditors.

The CGIR has alleged that the Appellant had reduced his profits by making fictitious entries in artificial transactions. The Respondent submitted that under Section 103 of the Inland Revenue Act, such transactions should be disregarded and should be assessed as undeclared profits.

The learned Counsel for the Appellant argued that the mere presence of errors does not make those entries fictitious and made with the intention to reduce the amount of tax payable.

Section 103 of the Act reads thus:

> ***103.*** *Where an Assessor is of the opinion that any transaction which reduces or would have the effect of reducing the amount of tax payable by any person is artificial or fictitious or that any disposition is not in fact given effect to, he may disregard any such transaction or disposition and the parties to the transaction or disposition shall be assessable accordingly.*
>
> *In this section "disposition" includes any trust, grant, covenant, agreement, or arrangement.*

The learned Counsel for the Appellant, citing Balaratnam,[20] argued that tax evasion and tax avoidance are two different concepts. Balaratnam, citing *R v. Dealy*,[21] states that the word "evasion" entails a deliberate non-payment of tax when payment is due. He further states that the words "wilful default" being used in conjunction with the words "fraud" and "evasion" in relation to income tax, makes it apparent that wilful default must be

[19] Paragraph 4(a) of the counter-submission made to the TAC by the Respondent, at p.76 of the appeal brief.

[20] S. Balaratnam, *Income Tax in Sri Lanka*, Third Edition, 2001. at p.658

[21] [1995] STC 217

some gravely serious kind of act such as might, in the appropriate case, lead to criminal proceedings.[22]

The learned Counsel for the Appellant also cited *Chellappah v. Commissioner of Income Tax* in support of his contention.[23] This was a case decided on Section 87 (1) of the Income Tax Ordinance.[24] Accordingly, it was held that the world "wilfully" should be construed as meaning *deliberately or purposely with the evil intent of committing the act or acts enumerated in the Section*. However, it is important to note that unlike in Section 87 (1) of the Income Tax Ordinance above, the phrase "wilfully with intent to evade" is not found in Section 103 of the Inland Revenue Act No. 10 of 2006, which is what the present appeal is based on.

Hence, in my view, the above argument has no merit.

As I have already stated above in this judgement, the amounts of money said to have been borrowed by the Appellant do not tally with the corresponding accounting entries of IWS Holdings (Pvt) Ltd.

Therefore, I am of the view that the Assessor is justified in forming an opinion that the entries are artificial and/or fictitious and making an assessment accordingly, acting under Section 103 of the Act.

For the reasons set out above, I answer all five questions of law in the negative, and in favour of the Respondent.

1. *Has the assessor and/or Commissioner General of Inland Revenue and/or Tax Appeals Commission acted arbitrarily in the computing of the Appellant's taxable income?* ***No***
2. *Has the Commissioner General of Inland Revenue and/or the Tax Appeals Commission erred in computing of the Appellant's taxable income?* ***No***
3. *Has the Tax Appeals Commission erred and/or misdirected itself and/or acted arbitrarily in rejecting the reconciliation provided by the Appellant's auditors?* ***No***

[22] S. Balaratnam, *Income Tax in Sri Lanka*, Third Edition, 2001. at p.658

[23] Ceylon Tax Cases, Vol. I, p.382

[24] Income Tax Ordinance 2 of 1932, as amended.

4. *Has the Tax Appeals Commission erred in law by taking into consideration the suspicions of the Representative of the Commissioner General?* ***No***

5. *Has the Tax Appeals Commission erred in law in interpreting and/or applying the provisions of Section 103 of the Inland Revenue Act?* ***No***

Acting under Section 11 A (6) of the TAC Act, I affirm the determination made by the TAC and dismiss this appeal.

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

JUDGE OF THE COURT OF APPEAL

Dr. Ruwan Fernando J.

I Agree.

JUDGE OF THE COURT OF APPEAL