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

In the matter of a Case Stated under Reference No. TAC/IT/021/2014 by the Tax Appeals Commission under Section 170 of the Inland Revenue Act, No. 10 of 2006 read together with Section 11A (1) of the Tax Appeals Commission Act, No. 23 of 2011 (as amended).

Setmil Developers Lanka (Pvt.) Limited.,
1st Floor, Setmil Maritime Center,
No. 256, Srimath Ramanathan Mawatha,
Colombo 15.

Appellant

Case No. CA/TAX/27/2019
Tax Appeals Commission
No. TAC/IT/021/2014

Vs.

The Commissioner General of Inland Revenue,
Department of Inland Revenue,
Inland Revenue Building,
No. 515, Sir Chittampalam A. Gardiner Mawatha,
Colombo 02.

Respondent

Before : Dr. Ruwan Fernando J. &

M. Sampath K.B. Wijeratne J.

: F.N. Goonewardena for the Appellant.

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

Argued on : 30.11.2021

Written Submissions filed on

: 18.11.2021 & 05.01.2022 (by the Appellant)

27.02.2022 (by the Respondent)

Decided on : 03.02.2022

Dr. Ruwan Fernando, J.

Introduction

[1] This is an appeal by the Appellant by way of a Case Stated against the determination of the Tax Appeals Commission dated 20.06.2019 confirming the determination made by the Respondent on 06.09.2014 and dismissing the Appeal of the Appellant. The taxable period related to the appeal is the year of assessment 2009/2010.

Factual Background

[2] The Appellant is a limited liability company incorporated and domiciled in Sri Lanka and engaged in the business of providing accommodation (lease out and rent out) of a modern office complex. The Appellant has entered into an Agreement with the Board of Investment of Sri Lanka (hereinafter referred to as the "BOI") on 02.05.2006 under Section 17 of the Board of Investment of Sri Lanka, Law, No. 4 of 1978 (hereinafter referred to as the "BOI Law") to set up/conduct a project for the construction and operation of a modern office complex (hereinafter referred to as the "project") land at No. 256, Srimath Ramanadan Mawatha, Colombo 15, morefully described in the First Schedule to the said Agreement.

[3] In terms of Clause 12 (i) of the Agreement with the BOI, the provisions of the Inland Revenue Act, No. 38 of 2000 relating to the imposition payment and recovery of income tax in respect of profits and income of the Enterprise shall not apply for a period of 3 years reckoned from the year of assessment as may be determined by the BOI. Accordingly, the BOI, by letter dated 07.01.2011 certified that the Appellant is entitled to the first year of tax holiday covering the period from 01.04.2009 to 31.03.2010.

[4] Consequently, the Appellant prepared its tax computation for the year of assessment 2008/2009 and filed the Tax Return with the Department of Inland Revenue on 26.11.2009 and stated that the Appellant incurred a loss from its business amounting to Rs. 29,453,164/ of which a sum of Rs. 29,374,703/-

was carried forward after deducting the loss of Rs. 78,461/- under Section 32 (5) (a) of the Inland Revenue Act, No. 10 of 2006.

[5] The Appellant filed the Return of income for the year of assessment 2009/2010 and carried forward the excess loss of Rs. 29,374,703/- to the year of assessment 2009/2010 against the interest income and claimed the said amount from the total statutory income under Section 32 (5) (a) of the Inland Revenue Act, No. 10 of 2006.

[6] The Assessor by intimation letter dated 26.06.2012 rejected the Return of Income for the year of assessment 2009/2010 on the ground that the carried forward loss declared for the year of assessment 2009/2010 is not applicable in computing the assessable income of the Appellant as the Inland Revenue Act, No. 10 of 2006 is not applicable during the tax holiday exemption period mentioned in the BOI Agreement. The determination of the Assessor at page 47 of the Tax Appeals Commission brief is as follows:

> *"Reason:*
>
> *During the tax holiday exemption period, the BOI company is allowed to enjoy all the benefits and privileges mentioned in the agreement with BOI and no application of the Inland Revenue Act, No. 10 of 2006.*
>
> *Therefore, the loss carried forward declared in the returns of income for the above year of assessments are not applicable in computing the assessable income".*

[7] Accordingly, the loss was adjusted by the Assessor as follows:

C/F loss from 2008/2009	29,374,704	-	Nil

	Y/A 2009/2010	**Y/A 2010/2011**
Taxable income	105,031	84,891
Tax @ 35%	36,761	29,712
SRL @ 1.5%	551	446

[8] Accordingly, the notice of assessment was issued in respect of the year of assessment 2009/2010 (p. 49). The Appellant appealed to the Commissioner-General of Inland Revenue (hereinafter referred to as the "Respondent") against the said assessment and the Respondent by its determination dated 06.09.2014 confirmed the assessment and dismissed the appeal (pp. 90-91 & 70-74 of the Tax Appeals Commission brief).

[9] The Commissioner-General confirmed the assessment of the Assessor and determined that the tax liability of the Appellant for the year of assessment 2009/2010 shall be as follows:

	Rs	Rs.
BOI loss brought forward from Y/A 2008/2009		29,374,703
Disallowed losses brought forward		29,374,703
Brought forward losses to Y/A 2009/2010		Nil
Interest Income		105,031
Total statutory income		105,031
BOI loss claim (35% of 29,374,703)	36,761	
Disallowed loss claim	36,761	
Loss allowed		Nil
Assessable income		105,031
Taxable income		105,031
Tax at 35%		36,761
SRL at 1.5%		551
Total Tax Liability		37,317

[10] The Respondent too confirmed the assessment on the basis that the Inland Revenue Act, No. 10 of 2006 is inapplicable to the profits and income of the Appellant during the tax exemption period 2009/2010 and the Inland Revenue Act is also inapplicable during the project implementation period 2008/2009. The Respondent further stated that the project costs during the project implementation period is part and parcel of the related cost of the BOI project, and as the losses from business were made during the project implementation period 2008/2009. The Respondent accordingly, determined that the losses incurred during the project implementation period cannot be carried forward and deducted against the assessable interest income in the year of assessment 2009/2010 under the Inland Revenue Act when the tax exemption period is covered by the BOI Agreement (p. 31). The relevant parts of the determination, read as follows:

> *"Since the company entered into an agreement with BOI for the aforesaid project from 02.04.2006 for tax purposes, the BOI Law supersedes the Inland Revenue Act. Hence, losses during the project implementation period cannot be claimed against the assessable income (interest income) under the Inland Revenue Law".*

Appeal to the Tax Appeals Commission

[11] Being dissatisfied with the said determination of the Respondent, the Appellant appealed to the Tax Appeals Commission and the Tax Appeals Commission in dismissing the appeal held that as the BOI Law supersedes the Inland Revenue Act, and the BOI Law applies to the year of assessment 2009/2010, the loss incurred during the year of assessment 2008/2009 cannot be carried forward to the year of assessment 2009/2010 by deducting the loss from the profit liable to income tax during the year of assessment 2009/2010. The relevant findings of the Tax Appeals Commission at page 105 of the Tax Appeals Commission brief are as follows:

> *"According to BOI Agreement and BOI letter dated 07.01.2010, the Appellant commenced their commercial operations from 2008/2009. Therefore, the Appellant had enjoyed a tax holiday from 2009. In this period, the Appellant was allowed to enjoy all the tax benefits according to the BOI Law. Hence, the Inland Revenue Act is not applicable to the Appellant from 2009/2010. In this matter, the exemption under the BOI agreement commenced in the year of assessment in which the Enterprise commenced to make profits in relation to its transactions in that year. In terms of the BOI agreement it is clear that the exemption was granted only for the profit and income of the Enterprise. The losses incurred prior to the commencement of the tax exemption period are not deductible for tax purposes. In terms of the letter dated 17.01.2011, the exemption commenced on 01.04.2009. The Appellant company made a profit in 2008/2009. Therefore, losses prior to the commencement of the tax exemption period are not deductible for tax purposes.*
>
> *After analysing the submissions made by the Representative of the Appellant and the Representative of the Respondent, we are of the view that the provisions of the Inland Revenue Act are not applicable to the Appellant from 2008/2009, further, we note that the BOI Law supersedes the Inland Revenue Act, No. 10 of 2006 for tax purposes. The Appellant Company cannot claim the loss brought forward from the year of assessment 2008/2009 since the Company was exempted from payment of tax and application of the provisions of the Inland Revenue Act".*

Questions of Law for the Opinion of the Court of Appeal

[12] Being dissatisfied with the said determination of the Tax Appeals Commission, the Appellant appealed to the Court of Appeal and formulated the following questions of law in the Case Stated for the opinion of the Court of Appeal.

(1) Has the Tax Appeals Commission erred in determining that the Inland Revenue Act, No. 10 of 2006 was not applicable to the Company for the year of assessment 2009/2010 in the context of the Company also

having profit, which was not covered by the BOI Agreement during the said year of assessment?

(2) Has the Tax Appeals Commission erred in determining that the tax losses incurred by the Company prior to the commencement of the tax exemption period (i.e., prior to the year of assessment 2009/2010) are not deductible from the profit liable to income tax during the year of assessment 2009/2010?

(3) Whether the Tax Appeals Commission erred in law to appreciate that the Department of the Inland Revenue has accepted the return of income filed for the year of assessment 2008/2009 in which the loss in question was claimed and carried forward to 2009/2010?

Submissions of the Parties

[13] At the hearing of the appeal, Mr. F.N. Goonewardena, the learned Counsel for the Appellant and Mrs. Chaya Sri Nammuni, the learned Senior State Counsel for the Respondent made extensive oral submissions in respect of the three questions of law submitted for the opinion of the Court.

[14] At the hearing, Mr. Goonewardena's main submission was that the losses incurred by the Appellant in the year of assessment 2008/2009 were lawfully incurred in terms of the Inland Revenue Act, No. 10 of 2006 as the tax exemption period covered by the BOI Agreement, commenced from the year of assessment 2009/2010. He further submitted that the lawfully incurred losses can be deducted against profits that are not covered by the BOI tax exemption period. Accordingly, he submitted that the profits, not related to the business activity of the Appellant stipulated in the BOI Agreement (sale/lease/rent) and carried forward to the subsequent year of assessment could be assessable under the Inland Revenue Act.

[15] He further argued that the Appellant was entitled to claim the loss incurred during the project implementation period and prior to the tax exemption period under Section 32 (5) (b) of the Inland Revenue Act, No. 10 of 2006. He relied on the decision of the Court of Appeal in *Commissioner-General of Inland Revenue v. Seylan Development PLC,* C.A. Tax, 10/2014, decided on 06.04.2017 in support of his contention.

[16] On the other hand, the learned Senior State Counsel submitted that although the BOI decided that the tax exemption commenced with effect from 01.04.2009 as per Section 12 of the BOI Agreement, the BOI cannot have an unfettered discretion to determine the tax exemption period without taking into account (i) the year in which the Enterprise made profit; (ii) the date of the

commencement of business, taking the earlier year as the commencement of the tax exemption period. She contended that as the commercial operations commenced from 2008/2009, and the Appellant made taxable profits in the year 2008/2009, the losses made during the period of commercial operations are not deductible as losses brought forward in the year of assessment under the Inland Revenue Act. She relied on the decision of the Court of Appeal in *Royal Ceramics Lanka PLC v. The Commissioner-General of Inland Revenue,* C.A. Tax 05/2008 decided on 12.05.2020.

[17] The main argument focused on the deductibility of the tax losses incurred by the Appellant during the period of commercial operations, but prior to the commencement of the tax exemption period by carrying them forward to the subsequent year of assessment from the previous year under Section 32 (5) (a) of the Inland Revenue Act, No. 10 of 2006.

Analysis

The BOI Agreement & the Project Implementation Period

[18] It is not in dispute that (i) the Appellant entered into an Agreement with the BOI on 02.05.2006 to set up/conduct a project for the construction and the operation of a modern office complex ("the project") land at No. 256, Srimath Ramanathan Mawatha, Colombo 15; and (ii) in terms of Clause 6 of the said Agreement, the Appellant agreed to "implement and commence commercial operations at the site within a period of twenty four (24) months" from the date of the Agreement. In terms of the BOI Agreement, the project implantation period was from 02.05.2006 to 31.03.2008 and thus, the Appellant was required to implement the project and commence its commercial operations during that period.

Extension of the Project Implementation Period

[19] It is not in dispute that upon a request made by the Appellant on 19.11.2010, the project implementation period was extended by the BOI by another one year and accordingly, the project implementation period was extended from 31.03.2008 to 31.03.2009 and the approval for the tax concession was received by the Appellant from the BOI by letter dated 07.01.2011 (p. 17).

Deductions of Income Tax in arriving at assessable Income

[20] The Appellant claimed that as the tax exemption period commenced in terms of the BOI Agreement from the year of assessment 2009/2010 as set out in the letter issued by the BOI on 07.01.2011, the losses that were incurred

from its business in the year of assessment 2008/2009 and carried forward to the subsequent year 2009/2010 under Section 32 (5) (a) of the Inland Revenue Act were not covered by the BOI Agreement.

[21] Section 32 of the Inland Revenue Act relates to the deductions from total statutory income in arriving at assessable income and Section 32 (5) (b) reads as follows:

> *"There shall be deducted from the total statutory income of a person* ***for any year of assessment-***
>
> *(a) the amount of a loss, other than a loss referred to in paragraph (c) or paragraph (d), incurred by such person in any trade, business, profession or vocation* ***which if it had been a profit would have been assessable under this Act****,* ***including any such loss brought forward from a previous year which had been deducted under this section previously,*** *and any excess treated as a loss under paragraph (ii) of the proviso to paragraph (a), upto a maximum limit of thirty five per centum of the excess of the total statutory income for that year over the aggregate of:-*
>
> *(i) statutory income from interest and dividends referred to in subsection (1);*
> *(ii) any interest income referred to in subsection (2); and*
> *(iii) any reward, share of fine, any lottery winning and any interest on compensation payable, as referred to in subsection (3)*
>
> *for that year of assessment and any loss which cannot be deducted, may be carried forward to the next year of assessment and so on:*
>
> *Provided, however*
>
> *(A) no loss incurred on the disposal of shares, rights or warrants in a company referred to in section 44 of this Act, shall be a loss deductible under this paragraph;*
>
> *(B) no loss shall be carried forward beyond the year of assessment in which the death of such person occurred in the case of an individual, or liquidation of such person occurred in the case of a company or other body of persons...*
>
> *(c)*
>
> *(D)....."*

[22] In order to decide whether the Appellant is entitled to deduct any loss incurred in the year of assessment 2008/2009 including any brought forward loss from a previous year from the profit in any year of assessment, this Court must consider the following questions:

1. Whether or not the Appellant had incurred a loss in the year of assessment 2008/2009 in its trade, business, profession or vocation;

2. Whether or not any loss incurred by the Appellant during the period of commercial operations, but prior to the commencement of the tax exemption period is covered by the BOI Agreement or the Inland Revenue Act;

3. If so, whether or not such loss could have been capable of being assessed under the Inland Revenue Act, as if it had been a profit in the year of assessment 2008/2009;

4. If so, whether or not, the loss that had incurred in the previous year 2008/2009 could be deducted against the assessable interest income and brought forward to the subsequent year of assessment 2009/2010 from the previous year under the Inland Revenue Act.

Whether the loss incurred by the Appellant in the year of assessment 2008/2009

[23] The taxable period in this matter relates to the year of assessment 2009/2010. In terms of the Tax Returns filed by the Appellant on 26.11.2009 for the year of assessment 2008/2009, the Appellant had incurred losses from its business amounting to Rs. 29,453,164/ of which a sum of Rs. 29,374,703 had been deducted and carried forward by the Appellant to the year 2009/2010 after deducting the loss of Rs. 78,461/- under Section 32 (5) (a) of the Inland Revenue Act (Vide- page 1 of the Return for the year 2008/2009 and the last page of Form C-201 Sc (2) in the docket).

[24] The Respondent's determination at page 30 of the Tax Appeals Commission brief has a table as per the income statement of accounts, which indicates that the Appellant had (i) commenced commercial operations and received rental income from commercial properties in the year 2008/2009, but the Appellant had made losses during the year of assessment 2008/2009. The table reads as follows:

	1	2	3	4
Y/A	2006/2007	2007/2008	2008/2009	2009/2010
VAT receivable on taxable supply, but not disclosed and not paid to the IRD	17,055.080	37,645,086	11,649,068	
VAT disclosed to the IRD	nil	nil	11,063,638	9,026,653
Revenue/Other income				
Rent income	nil	nil	37,843,920	64,719,360

Other income-service supplied	nil	nil	6,051,434	8,218,878
Interest on savings accounts	463,394	253,477	224,175	105,031
Interest on call deposit	1,426,432			
Non defendable security deposit	86,700			
	1,976,526	253,477	44,119,529	73,043,269
Loss-administrative+ Finance cost	3,585,826	5,082,508	55,721,028	67,894,569
Loss for the year	(1,609,300)	(4,829,031)	(11,601,499)	
Profit for the year				5,148,700

[25 The Respondent did not dispute the claim of the Appellant that during the year of assessment 2008/2009, the Appellant incurred losses from its business amounting to Rs. 29.453,164 of which a sum of Rs. 29,374,703/- was carried forward by the Appellant to the year of assessment 2009/2010.

Tax Exemption Period

[26] The next question is to decide whether the year of assessment 2008/2009 was a year during the tax exemption period of 3 years in terms of the BOI Agreement. In terms of Section 12 of the said Agreement, the Appellant was entitled to a tax exemption of three (03) years reckoned from the year of assessment **as may be determined by the BOI** and **during the said period of 3 years** and the provisions of the Inland revenue Act, No. 38 of 2000 in relation to the imposition, payment and recovery of income tax in respect of the Appellant's profits and income would not apply. Clause 12 (i) reads as follows:

> *"For a period of three (03) years reckoned from the year of assessment **as may be determined by the Board** ("the tax exemption period"), the provisions of the Inland Revenue Act, No. 38 of 2000 relating to the imposition, payment and recovery of income tax in respect of the profits and income of the Enterprise shall not apply to the profits and income of the Enterprise".*

Calculation of the *year of assessment* for the purpose of tax exemption period

[27] For the purpose of the tax exemption period, Clause 12 (1) of the BOI Agreement further provides that the year of assessment shall be calculated as follows:

> *"For the above purpose, the year of assessment shall be reckoned from the year in which the Enterprise commences to make profits in relation to its transaction in that year or any year of assessment not later than two*

(02) years from the date of commencement if commercial operations of the Enterprise, whichever year is earlier, ***as may be specified in the certificate issued by the Board".***

Tax exemption period and the commencement of the tax exemption period

[28] Now the question is: when does the tax exemption period commence in terms of the BOI Agreement, and who should determine the tax exemption period? A perusal of Clause 12 (i) of the Agreement reveals that first, there are two basic rules that must be fulfilled for a tax exemption period of 3 years to commence from any year of assessment as may be determined by the BOI. Those two rules are as follows.

1. (a) Either the Appellant must have commenced to make profits in relation to its transaction in that year (rule 1); or

   (b) any year of assessment not later than 2 years from the date of commencement of commercial operations,(rule 2) whichever year is earlier,

2. The year of assessment must have been determined and specified in a certificate issued by the BOI.

Who should determine the tax exemption period and the date of the commencement of the tax exemption period?

[29] According to Clause 12 (i) of the BOI Agreement, the BOI must determine the tax exemption period of 3 years, which shall be reckoned according to the above-mentioned two rules as may be specified in a certificate issued by the BOI. At the hearing, the learned Senior State Counsel conceded that it was the BOI that must determine the tax exemption period as per Clause 12 (i) of the BOI Agreement. Her submission was, however, that the question whether the loss which, if it had been a profit, and whether it is deductible must be decided by the Respondent and not be the BOI having regard to the date of the commencement of the commercial operations of the Appellant.

[30] The certificate issued by the BOI dated 07.01.2011 as required by Clause 12 (i) of the BOI Agreement reads as follows:

"We refer to the Principal Agreement dated 02.05.2006, entered into between the Board of Investment of Sri Lanka and your enterprise and observed that ***you have met the investment criterion.***

Accordingly, we wish to certify that your ***enterprise is entitled for the first year of tax holiday covering the period from 01.04.2009 to 31.03.2010****.*

With regard to the balance two (02) years, period your enterprise is required to obtain tax certificates from BOI confirming your tax entitlement for the years 2010/2011 to 2011/12 which will be issued by the BOI, on reviewing the performance of your Enterprise.

Please note that any income generated by your enterprise other than the activity approved by the said Agreements, is liable for the payment of income tax and other applicable tax if any.

Accordingly, ***the tax certificate for the year 2008/09 does not arise****, as requested by your letter dated 19th November 2010".*

[31] Admittedly, the BOI determined that the Appellant had met with the investment criterion and certified that the Appellant was entitled to the tax exemption period of 3 years commencing from **01.04.2009 to 31.03.2010**. In other words, the BOI determined that the tax exemption period of 3 years shall be reckoned from the **year of assessment commencing from 01.04.2009 to 31.03.2010** and therefore, the year of assessment commencing from 01.04.2008 to 31.03.2009 is not qualified to be a year of the tax exemption period in terms of the BOI Agreement.

When did the Appellant commence to make a profit in relation to its transaction for the purpose of determining the tax exemption period?

[32] The next question is to decide the first rule in Clause 12 (i) for the purpose of the year of assessment which is crucial to determine whether or not the loss which, if it had been a profit would be deductible under Section 32 (5)(b) of the Inland Revenue Act. The transaction in question relates to the setting-up and conducting of a modern office complex and any income other than the business income falls outside the BOI Agreement. Accordingly, the Appellant must have commenced making a profit **in relation to its transaction in that year,** namely, from its business activity approved by the BOI.

[33] As stated, the BOI determined that the tax exemption period commences with effect from 01.04.2009 and therefore, any profit that may have been made by the Appellant during that year of assessment 2009/2010 is covered by the BOI Agreement and thus, such profit made during that year of assessment 2009/2010 (from 01.04.2009 to 31.03.2010) falls within the tax exemption period of 3 years. In other words, any profit that may have been made during the said year of assessment from 01.04.2009 to 31.03.2010 (2009/2010) is not assessable under the Inland Revenue Act as the tax exemption period under the BOI Agreement applies to that year.

[34] The income statement of accounts at page 70 of the Tax Appeals Commission brief for the year 2008/2009 states that the Appellant had received rental income in a sum of Rs. 37,843,920/) from the business activity, but the

Appellant had incurred a loss in the said year of assessment 2008/2009. It further confirms that no profits had been made by the Appellant in relation to business transactions in the year 2008/2009. The Appellant has, however, commenced to make profits only for the year of assessment 2009/2010 (p. 30) and therefore, the Appellant had not commenced to make profits in the year of assessment 2008/2009 in relation to the business activity approved by the BOI. Accordingly, the tax exemption only commenced during the year of assessment 2009/2010 which is the first year of tax holiday covering the period from 01.04.2009 to 31.03.2010.

Did the Appellant commence to make a profit in any year of assessment not later than 2 years from the date of commencement of commercial operations?

[35] The learned Senior State Counsel, however, relied on the second rule in Clause 12 (i) of the BOI Agreement and submitted that the commercial operations commenced in the year 2008/2009 as the Appellant made rental income from its commercial operations and therefore, the year 2008/2009 has to be regarded as the date of the commencement of the tax exemption period. She submitted that any loss if it had been a profit in the year 2008/2009 cannot be losses brought forward from the previous year to the taxable year of assessment 2009/2010 as such profits would be tax exempt under the BOI Agreement.

[36] The tax exemption period commenced from the year of assessment 2009/2010 and the first year of the tax exemption period was from 01.04.2009 to 31.03.2010 as certified by the BOI and the Appellant's entitlement to the tax exemption for the years 2010/2011 to 2011/12 were to be issued by the BOI on reviewing the performance of the Enterprise. The commercial operations commenced and the Appellant received rental income in the year 2008/2009 as the first rental was received only in that year (2008/2009). As stated, the initial project implementation period was 2 years (02.05.2006 to 31.03.2008) and with the additional one year granted by the BOI, the project implementation period continued till 31.03.2009 and the commercial operations commenced and the rental income received only during that period. In these circumstances, the year of assessment for the purpose of tax holiday cannot be regarded as the year 2008/2009 under rule 2 when the project implementation period and the date of the commencement of the commercial operations of the Enterprise fall within the year 2008/2009.

[37] Accordingly, the year of assessment 2008/2009 is not qualified to be a year of tax exemption as it has not met any of the two rules set out in the BOI Agreement. In my view, the determination made by the BOI as specified in the

certificate issued by the BOI on 07.01.2011 is consistent with Clause 12 (i) of the BOI Agreement.

Fulfillment of Investment Criteria

[38] At the hearing Mr. Goonewardene submitted that in addition to the said two rules referred to in Clause 12 (i), the Appellant had to satisfy certain additional preconditions set out in Clause 7 of the BOI Agreement, and therefore, even if the Appellant had made a profit in the year 2008/2009, the Appellant would not be entitled to tax exemption under the BOI Agreement unless the Appellant was able to satisfy the investment criteria set out in Clause 7. Accordingly, he submitted that the Respondent's contention that as the Appellant had made taxable profits during the year of assessment 2008/2009, the tax exemption period would *ipso facto* come into effect is erroneous.

[39] The learned Senior State Counsel conceded that additionally, the BOI must be satisfied that the Enterprise had fulfilled the investment criteria within 24 months from the date of the Agreement as set out in Clause 7 of the BOI Agreement. She submitted, however, that there is no document whatsoever, to substantiate as to when exactly the Appellant completed the investment criteria as the Returns were filed on 29.11.2010 whereas the certificate was issued on 07.01.2011 and therefore, the only assumption is that the investment criteria were fulfilled by the Appellant after the commencement of the commercial operations in 2008.

[40] Her submission was that as no assumption can be made on the basis of the letter dated 07.01.2011 issued by the BOI, the question whether the loss claimed by the Appellant can be considered as a profit within the period of the commercial operations and that it was a loss brought forward from the previous year 2008/2009 to the year of assessment 2009/2010 for tax exemption under Section 32 (5) (b) of the Inland Revenue Act must be decided by the Respondent and not the BOI

[41] A perusal of the appeal determined by the Commissioner-General further reveals that in confirming the assessment, he had questioned the validity of the approval granted by the BOI on 10.11.2011 by extending the project implementation period by one year after the lapse of the original project implementation period by backdating the effective date of the project implementation period. On that basis too, the Commissioner-General determined that the commercial operation commenced in the year of assessment 2008/2009 and therefore, the losses cannot be allowed during the tax exemption period. His findings at page 30 of the brief are as follows:

"The enterprise would have implemented and commenced operations at the site within a period of twenty four months (24) from the date 02 April, 2006 (it means within the period from 02.04.2006 to 31.03.2008 (Y/A 2006/2007 and 2007/2008). An additional one year (Y/A 2008/2009) extending the project implementation period has been granted on request made to that effect by the company on 19 November 2010, accordingly, the project implementation period seems to have been allowed by backdating the effective date after the lapse of twenty (20) months of the year of assessment 2008/2009. Approval for the tax exemption has been received from the BOI on 07.01.2011. This approval received is questionable. Accordingly, the commercial operation has been commenced Y/A 2008/2009. So, losses cannot be allowed during the tax exemption period".

[42] The learned Senior State Counsel further submitted that as the commercial operations were deferred until 2009 and the Appellant made business income in the year 2008/2009, the Assessor was entitled to hold under the two rules that the investment was done within 2 years after the commencement of business in 2008.

Proof of minimum Investment committed to the project for the purpose of tax exemption

[43] Clause 6 of the Agreement provides that:

"The Enterprise shall implement and commence commercial operations at the site within a period of 24 months from the date hereof". (02.05.2006).

[44] In terms of Clause 6 of the Agreement, the Appellant shall implement and commence commercial operations within 24 months from 02.04.2006. The project implementation period that is set out in the BOI Agreement was extended by the BOI by an additional one year until 31.03.2009. In terms of the Agreement, the tax exemption period, including the commencement of the said period from the date of the year of assessment as set out in the Agreement is determined and declared in the certificate issued by the BOI.

The Additional precondition for the operation of tax holiday period

[45] A perusal of Clause 7 of the BOI Agreement, however, reveals that the entitlement to the tax exemption period referred to in Clause 12 of the BOI Agreement depends on the fulfilment of the following additional pre-conditions by the Enterprise:

"7- The Enterprise shall be entitled to the above mentioned tax concessions referred to in sub-clause (i), (ii) and (iii), of clause (12) hereof on the following specific undertakings of the Enterprise that:

The minimum investment committed to the project of the Enterprise within a period of twenty four (24) months from the date hereof shall be not later than United States Dollars Five Million (US$ 5 Mn) or its rupee equivalent.

However, the Board noted that in terms of the investment application the Enterprise has envisaged to invest a sum of Rupees Six Hundred Million (Rs. 600 Mn) in the Project; and

Financing of the project shall consist only share capital loan capital, which may be contributed by the investors or provided by Banks or Financial Institutions. Any pre sale advances collected from the purchases shall not be considered as part of investment..."

[46] In terms of the Clause 7 of the BOI Agreement, the Appellant to be entitled to the tax concession referred to in Clause 12, must satisfy the minimum investment committed to the project (a sum of US$ 5 Million within a period of 24 months from the date of the Agreement).

[47] Under such circumstances, I hold that it is the BOI that must determine the project implementation period and the date of the commencement of the tax exemption period, which must be specified in a certificate issued by the BOI having regard to the two rules set out in Clause 12 (i) of the Agreement. I further hold that it is the BOI that must determine whether or not the Appellant had met the investment criteria before determining whether or not the Appellant is entitled to the tax concessions referred to in Sub-Clauses (i), (ii) and (iii) of Clause 12 (i) of the Agreement.

[48] It is obvious that the BOI could not have determined that the Appellant had met the investment criterion and issued a certificate determining the tax exemption period before the lapse of (i) the period of 24 months from the date of the Agreement (Clause 6) and (ii) the extended project implementation period granted by the BOI (31.03.2009).

[49] The period of 24 months set out in the Agreement for the project implementation was extended by the BOI and when the Appellant satisfied the minimum investment committed to the project during the extended project implementation period, the BOI decided by letter dated 07.06.2011 that the Appellant had met the investment criterion (p. 17). The BOI by the same letter determined that the Appellant was entitled to the first year of tax holiday, covering the period from 01.04.2009 to 31.03.2010 (2009/2010) and not prior to that year of assessment (2009/2010) date

[50] Accordingly, there is no merit in the Respondent's argument that the BIO tax exemption period applied to the Appellant in the year of assessment 2008/2009 on the ground that the commercial operation commenced in that year of assessment 2008/2009 when the BOI determined on 07.01.2011 that

the Appellant had met with the investment criterion and the tax exemption period commenced with effect from 01.04.2009.

BOI Approved Business Activity

[51] At the hearing, Mr. Goonewardene argued that the tax exemption is only applicable to the profits and income generated by the Appellant from the BOI project, but all other income, including the interest income is not directly connected with the profits and income of the Appellant. Accordingly, Mr. Goonewardene submitted that the Appellant is not entitled to claim tax exemption in respect of such interest income received by the Appellant prior to the tax exemption period.

[52] The BOI Agreement relates to the profits and income generated by the Enterprise from such BOI approved activity as Clause 12 (i) clearly provides that the tax exemption of 3 years applies to the imposition, payment and recovery of income tax in respect of the Appellant's profits made only in relation to its business transactions set out in the BOI Agreement. All other income, including the interest income generated by the Appellant other than the activity approved by the BOI Agreement prior to the tax exemption period and set off against the losses incurred by the Enterprise is liable for the payment of income tax under the Inland Revenue Act. This position is further confirmed by paragraph 4 of the BOI letter dated 07.01.2011:

> *"Please note that any income generated by your enterprise other than the activity approved by the said agreements, is liable for the payment of income tax and other applicable taxes if any".*

[53] The Commissioner-General in confirming the assessment made by the Assessor has taken the view that the project costs during the project implementation period is part and parcel of the related cost of the BOI project in ascertaining the profit which cannot be separated:

> *"the project costs during the project implementation period is part and parcel of the related cost of the BOI project in ascertaining of the profit which cannot be separated and accordingly, the assessment issued by disallowing the cost during the project implementation period treated as a loss is confirmed" (Vide- page 31 & 71 of the Tax Appeals Commission brief).*

[54] No satisfactory explanation has been given by the Assessor or the Commissioner-General of Inland Revenue as to how the Interest Income generated by the Appellant in 2008/2009 prior to the tax exemption period is directly connected with the business activity approved by the BOI Agreement

when the tax exemption period commenced from 01.04.2009 as determined and certified by the BOI in its letter dated 07.01.2011 (p. 17).

[55] I shall now consider the two authorities relied on by both Counsel in support of their respective positions. In *Commissioner-General of Inland Revenue v. Seylan Development PLC* (supra), the Respondent entered into an Agreement with the BOI and Clause 10 (1) of the said Agreement provided an identical tax exemption Clause in the present case, except the period of tax holiday which was 5 years whereas it is 3 years here. The Respondent sought to deduct the loss incurred in the year 1998/1999 from the total statutory income as that loss could have been assessable under Section 32 (5) (b) of the Inland Revenue Act, No. 10 of 2006.

[56] The Court of Appeal was called upon to decide as to whether it was the BOI or the Inland Revenue Act, which must determine when the tax exemption period commences, and whether the year of assessment 1998/1999 is qualified to be a year of tax exemption in terms of the two rules set out in Clause 10 (1) of the BOI Agreement. His Lordship Surasena, J. held that:

> "*Careful consideration of clause 10 (1) of the Agreement shows that there must be two basic requirements for the tax exemption period to commence. Those two requirements are as follows:*
>
> 1. *Either the Respondent must have commenced making profits or a period of 5 years must have lapsed from the date of its commercial or production operation;*
> 2. *The BOI must have determined and specified the year (described in "I" above) in a certificate issued by the Board.*
>
> *Therefore, in any case, it is the BOI which must determine the date of commencement of the tax exemption period, which must be specified in a certificate issued by the board. The BOI pursuant to that agreement has determined that the Respondent is entitled to the Tax Holiday period of 5 years commencing from 2003.04.01 to 2008.09.03".*

[57] Having perused the certificate which confirmed that the Respondent complied with the investment criterion as required by Clause 10 (1) of the said agreement, and that the Respondent was entitled for the tax holiday period of 5 years commencing from 01.04.2003 to 31.03.2008, His Lordship Surasena, J. held at page 16:

> *"These facts clearly show that the year of assessment 1998/1999 is not qualified to be a year of tax exemption as it has not met any of the two requirements set out above. Therefore, the year of assessment 1998/1999 is not within the tax exemption period determined by the BOI. Thus, any profit that may have been made during that year becomes*

assessable under the Act as the tax exemption does not apply to that year. Therefore, any loss that the Respondent had incurred in the year 1998/1999 could be deducted from the total statutory income as that amount of the loss could have been assessed under the Act if it had been a profit."

[58] The learned Senior State Counsel who, however, relied on the decision of this Court in *Royal Ceramics v. Commissioner-General of Inland Revenue* (supra) and submitted that for Section 32 (5) (a) of the Inland Revenue Act to apply, it must be assumed that the Appellant made profits in the following year, and therefore, the losses are permitted to be deducted in the following year on the assumption that the loss, if it had been a profit, would be taxable.

[59] In *Royal Ceramics v. Commissioner-General of Inland Revenue* (supra), the Appellant incurred trade losses for the years of assessment 1993/1994 and 1994/1995 but earned interest income for the same period and deducted the trade losses from the income earned from interest. The Assessor rejected the return by disallowing the trade losses deducted from the interest income from fixed deposits as not being in accordance with section 29 (2) (b) of the Inland Revenue Act, 1979 and issued assessments.

[60] The issue was whether the Appellant was entitled, in terms of Section 29 (2) (b) of the Inland Revenue Act, 1979 to deduct trade losses from the interest income from fixed losses incurred for the year of assessment 1993/94 and 1994/1995 in carrying on industrial undertaking qualified to be exempted from the payment of income tax in terms of section 17C (1) of the Inland Revenue Act, 1979. Section 17C (1) permitted the profits and income of any company to be exempt from income tax for a period of 5 years reckoned from the year of assessment in which such company commenced to make profits in respect of its transactions in that year.

[61] On the other hand, Section 29 (2) (b) allowed the deduction of a loss incurred by a person from its total statutory income for any year of assessment, which, if it had been a profit would have been assessable under the Inland Revenue Act, 1979 or the Inland Revenue Act, No. 4 of 1963, and which has not been allowed against his statutory income of a previous year under these Acts.

[62] The Court of Appeal decided that although the Appellant commenced to make profits in the year of assessment 1996/97, the years of assessment relevant to the matter were 1993/94 and 1994/95 and for the application of Section 29 (2) (b), and found at page 7 that:

"*However, for Section 29 (2) (b) of the IRA 1979 Act to apply, it must be assumed that the Appellant made profits in 1993/94. The Appellant would*

not, in view of the exemption granted by Section 17C (1) of IRA 1979 being then engaged, then, have been assessable under Section 3 (a) of the IRA 1979 Act. Hence, the trade losses incurred during this period would not be deductible in terms of Section 29(2) (b) of the IRA 1979 Act".

[63] In *Royal Ceramics v. Commissioner-General of Inland Revenue* (supra), the Court of Appeal held that although the Appellant commenced to make profits in the year of assessment 1996/97, the years of assessments related to 1993/94 and 1994/95 and for the operation of Section 29 (2) (b), it must be assumed that the Appellant made profits in the relevant year of assessment 1993/94. The Court found that the Appellant made profits in the year 1996/97 whereas the years of assessment related to 1993/94 and 1994/95 and thus, the exemption under Section 17C (1) would not be available. For those reasons, His Lordship Janak de Silva, J. held that the losses incurred during the year of assessment 1996/97 would not be deductible in terms of Section 29 (2) (b) of the Inland Revenue Act, 1979.

[64] It is crystal clear in the case of *Royal Ceramics v. Commissioner-General of Inland Revenue* (supra), it was the Department of Inland Revenue that determined when the tax exemption period under Section 17 C (1) of the Act, whereas in the present case, it was the BOI that must determine when the tax exemption period commenced. It is abundantly clear that the facts of the case *in Royal Ceramics v Commissioner-General of Inland Revenue* (supra) are different and can be distinguished from this case. In my view, the decision of the Court of Appeal in *Royal Ceramics v Commissioner-General of Inland Revenue* (supra) is inapplicable to the present case, whereas the decision of the Court of Appeal in the *Commissioner-General of Inland Revenue v. Seylan Development PLC* (supra) supports the contention of Mr. Gonewardene..

Whether the loss could have been capable of being assessed under the Inland Revenue Act, if it had been a profit in the year of assessment 2008/2009

[65] First, for the purpose of the application of Section 32 (5)(a), it must be speculated that the loss of Rs. 29,453,164/- incurred in the year of assessment 2008/2009 was in fact a profit made in the said year of assessment. Second, it must be satisfied that the said loss incurred in the year of assessment 2008/2009 would have been assessable under the Inland Revenue Act in the year of assessment 2008/2009 having regard to the year of assessment that had been determined by the BOI and specified in a certificate issued by the BOI.

[66] As described, the BOI has determined that the Appellant was entitled to the tax exemption period of 3 years commencing from 01.04.2009 to 31.03.2010 and thus, the year of assessment for the purpose of the tax

exemption period shall commence from the year of assessment 2009/2010. The said loss which was in fact a profit made for the purpose of Section 32 (5) (b) had been incurred in the year of assessment 2008/2009. The said profit would not have been assessable under the Inland Revenue Act if that profit was made during the tax holiday period determined and specified by the certificate issued by the BOI as the Inland Revenue Act shall not apply to the profits and income of the Appellant during the said tax exemption period commencing from the year of assessment 2009/2010 [Clause 12 (i)].

[67] As the year of assessment 2008/2009 (01.04.2008 to 31.03.2010) does not fall within the tax exemption period determined by the BOI, any profit that may have been made by the Appellant during that year of assessment 2008/2009, does not fall under the BOI Agreement. The year of assessment 2008/2009 is not qualified to be a year of tax exemption under Clause 12 (i) of the BOI Agreement as it occurred prior to the tax exemption period 2009/2010 determined by the BOI. Accordingly, the loss of Rs. 29,453,164/- incurred during that year of assessment (2008/2009) and prior to the tax exemption period (2009/2010) becomes assessable under the Inland Revenue Act as the BOI tax exemption period does not apply to that year of assessment 2008/2009.

[68] For those reasons, I hold that the loss of Rs. 29,453,164/- would not cover under the BOI Agreement and the said loss incurred by the Appellant in the year of assessment 2008/2009 would have been assessable under the Inland Revenue Act. Accordingly, the Appellant is entitled to deduct the said loss incurred prior to the tax exemption period and carried forward the said loss to the next year of assessment 2009/2010 in terms of Section 32 (5) (b) of the Inland Revenue Act, No. 10 of 2006.

[69] The Tax Appelans Commission has erred in holding that the tax losses incurred by the Appellant prior to the commencement of the tax exemption period (prior to the year of assessment 2009/2010) are not deductible from the profits liable to income tax during the year of assessment 2009/2010.

Conclusion & Opinion of Court

[70] For those reasons, I hold that the loss of Rs. 29,374,942/- from the Appellant's business in the year of assessment 2008/2009 of which Rs. 29,337,307/- was carried forward as an excess loss to the year of assessment 2009/2010 could be deduced from the profit liable to income tax during the year of assessment 2009/2010 under the Inland Revenue Act, No. 10 of 2006.

[71] In these circumstances, I answer questions of law arising in the Case Stated in favour of the Appellant and against the Respondent as follows:

1. Yes;
2. Yes;
3. Yes.

[72] For those reasons, I annul the assessment determined by the Tax Appeals Commission dated 20.06.2019 and 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