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 questions 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).

V. A. Muttiah,
671/9, Pannipitiya Road,
Thalawathugoda.

Appellant

Case No. CA/TAX/0001/2022
Tax Appeals Commission
No. TAC/IT/050/2017

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 : Suren Fernando for the Appellant

Manohara Jayasinghe, Deputy Solicitor General, for the Respondent

Argued on : 23.11.2022 & 19.01.2023

Written Submissions filed on	:	28.02.2023 & 21.10.2022 (by the Appellant) 22.03.2023 & 11.11.2022 (by the Respondent)
Decided on	:	31.03.2022

Dr. Ruwan Fernando, J.

Introduction

[1] This is an Appeal by way of a case stated against the determination of the Tax Appeals Commission dated 11.11.2021 confirming the determination of the Respondent dated 16.01.2017 and dismissing the Appeal of the Appellant. The period relates to the year of assessment 2011/2012.

Factual Background

[2] The Appellant Mr. S.P. Muttiah is the precedent partner of "A. Valentine Trading Co." which is registered as a partnership and the nature of the business is a property development and letting premises for commercial purpose. The Appellant submitted his returns for the said year 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 (hereinafter referred to as the Inland Revenue Act). The Appellant further claimed interest expenses under section 32(5)(a) of the Inland Revenue Act. The Deputy Commissioner by letter dated 28.11.2014 refused to accept the same and issued assessment for the following reasons:

1. The concessionary tax rate of 10% provided under Item 31 of the Fifth Schedule to the Inland Revenue Act is applicable for any undertaking carried on in Sri Lanka for operation and maintenance of facilities for storage. As per the lease agreements, the Appellant has rented out buildings for longer periods on agreements and the Appellant's source of income is purely rental income and not business income;

2. As per the lease agreements, the Appellant is not an undertaking carried on in Sri Lanka for the operation and maintenance of facilities for storage, and therefore, the Appellant is not entitled to apply for the concessionary

tax rate of 10% provided under item 31 of the Fifth Schedule to the Inland Revenue Act;

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

4. The Appellant is not entitled to deduct the interest paid under section 32(5) of the Inland Revenue Act due to the absence of documents annexed with the return in proof of such interest payment made under section 32(5) of the Inland Revenue Act.

[3] 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 16.01.2017 revised the said assessment by allowing the interest paid on the loan taken for the construction of the building in terms of section 32 (5) of the Inland Revenue Act. Accordingly, the Respondent reduced the assessment issued for the year of assessment 2001/2012 and the tax liability was determined as follows:

Year of Assessment	Tax Payable	Penalty	Total Tax Payable
2011/12	Rs. 937,030	Rs. 468,515	Rs. 1,445,545

Appeal to the Tax Appeals Commission & the Court of Appeal

[4] Being dissatisfied with the said determination of the Respondent, the Appellant appealed to the Tax Appeals Commission and the main questions that were considered by the TAX Appeals Commission were:

1. Whether Deputy Commissioner had failed to give reasons for not accepting the returns of the Appellant in terms of section 163(3) of the Inland Revenue Act;

2. Whether the Appellant was an undertaking carried on in Sri Lanka for operation and maintenance of facilities for storage to be entitled to secure 10% concession under item 31 of the Fifth Schedule to the Inland Revenue Act;

3. In the event, the Appellant failed to secure 10% concession under item 31 of the Fifth Schedule, whether the Appellant is still entitled to the 10% concession under section 59B of the Inland Revenue Act.

[5] The Tax Appeals Commission, in its determination dated 11.11.2021 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 his 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 31of the Fifth Schedule to the Inland Revenue Act;

3. The activity carried out by the Appellant was only renting out his 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 his premises should be calculated in terms of Section 6 of the Inland Revenue Act, and thus, the Appellant is not entitled to secure the concessionary tax rate provided in Item 31 of the Fifth Schedule to the Inland Revenue Act.

5. The term "undertaking" in section 59B of the Inland Revenue Act cannot be applied to treat the activity of the Appellant as a business, and therefore, the Appellant is not an undertaking within the meaning of section 59B of the Inland Revenue Act. The Appellant is therefore, not entitled to secure the concessionary tax rate of 10% under section 59B of the Inland Revenue Act.

[6] The Tax Appeals Commission (hereinafter referred to as the TAC) by its determination dated 11.11.2021 confirmed the determination of the Respondent and dismissed the appeal subject to the qualification that if the

Respondent is satisfied with the documents submitted, it should allow the interest expenses claimed on the loan taken for refurbishment of warehouses.

[7] 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. Is the assessment, and the determination of the Commissioner General, and the determination of the Tax Appeals Commission pursuant to same) liable to be quashed and/or annulled inasmuch as the assessor failed to duly provide reasons for the assessment as required by section 163(3) of the Inland revenue Act, No. 10 of 2006 (as amended)?

2. Is the Appellant entitled to the benefit of the concessionary tax rate of 10% provided under and in terms of item 31 of the 5th Schedule to the Inland revenue Act, No. 10 of 2006 (as amended) in view of the fact that the undertaking provided storage facilities as set out in the said item 31?

3. In any event, is the Appellant entitled to the concessionary tax rate of 10% as provided in section 59B of the Inland Revenue Act, No. 10 of 2006, as amended, in view of the fact that the turnover of the undertaking was less than rupees three hundred million in the relevant year of assessment?
4. 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)?

5. Is the assessment, (and the determination of the Commissioner General and the determination of the Tax Appeals Commission, thereon) excessive and contrary to law?

6. In view of the evidence and material before the Tax Appeals Commission, did the Tax Appeals Commission err in law in arriving at the conclusion set out in its determination?

[8] At the hearing of the Appeal, we heard, Mr. Suren Fernando, the learned Counsel for the Appellant and Mr. Manohara Jayasinghe, the learned Deputy Solicitor General for the Respondent. At the commencement of the hearing, Mr. Suren Fernando intimated to Court that he did not wish to pursue the questions of law No. 1 and 4 (Vide- the journal entry dated 23.11.2022). Accordingly, Mr. Suren Fernando confined his submissions mainly on the questions of law No. 2 and 3.

[9] At the hearing, Mr. Suren Fernando submitted that the TAC erred in relying on the erroneous ruling made by the Committee for Interpretation of Tax Laws dated 29.05.2015 that ruled that the term "business" has been defined in Section 217 of the Inland Revenue Act, referring to an activity carried out only by a company. Mr. Suren Fernando 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. He submitted that 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 to both business profits and income of such an undertaking who is either an individual or company. He submitted 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.

[10] The learned Deputy Solicitor General 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. He 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.

[11] 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.

Analysis

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

[12] Let me now consider the first argument of Mr. Suren Fernando that the Appellant is entitled to the concession in terms of item 31 of the Fifth Schedule regardless of whether it operates and maintains the storage facilities itself since the Appellant is an undertaking within the meaning of item 31 of the Fifth Schedule to the Inland Revenue Act. This Court is thus called upon to consider the meaning of the expression "undertaking" specified in item 31 of the Fifth Schedule to the Inland Revenue Act, and then decide whether the Appellant as an undertaking carried on in Sri Lanka for operation and maintenance of facilities for storage.

[13] Before proceeding to deal with the issues involved in the second and third Questions of Law, I shall refer to the relevant provisions of the Inland Revenue Act, No. 10 of 2006. 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 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 said Act. The expression "undertaking" has, however, 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 GmbH,* Case C-41/90 decided on 23.04.1991, sought to maximize the application of competition law by taking a broad definition of "undertaking". The traditional definition in *Klaus Hofner and Fritz Elser v. Macrotron GmbH* (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* (CA/Tax/49/2019 decided on 26.03.2021), 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] The TAC in its findings held that:

1. an 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;
2. the activity carried out by the Appellant is clearly renting of premises, which falls under Section 3 (g) of the Inland Revenue Act;
3. the activity carried out by the Appellant is clearly renting of premises, which will fall under Section 3 (g) and not under section 3(a) of the Inland Revenue Act; and
4. the Appellant's activity of renting of premises cannot be treated as an undertaking or as a business.

[22] The relevant finding of the TAC at p. 9 of the determination reads as follows:

"The term "undertaking" means a kind of business and the term "business" is defined in section 217 of the Inland Revenue Act 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 forestry". The definition cannot be overlooked. Therefore, it is seen that letting or leasing of a premises is treated as a business only, if such activities are carried out by a company. In any other circumstances, profit and income from letting premises by any person other than a company is treated as income from renting of properties falling under section 3(g) of the Inland Revenue Act. It has been argued that the term "undertaking" cannot be restricted to a business and that even facilities for storage would come within the meaning of an undertaking. However, it is seen that the Appellant is only renting out commercial premises. Therefore, the term "undertaking" referred to in section 58B cannot be applied to treat the activity of the Appellant as a business, in view of the definition of business given in section 217 of the Inland Revenue Act".

[23] I now desire to consider the question whether the concessionary rate of tax referred to in item 31 applies only to a company and thus, an undertaking can only be applied to an activity carried out by a company and not an activity carried out by an individual. Construing this word "business", the Indian Supreme Court in *Narain Swadeshi Weaving Mills v. Commissioner of Excess Profits Tax* [1954] 26 ITR 765 (SC) 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 of India in a later decision in *Mazagaon Dock Ltd. v. Commissioner of Income Tax* (1958) 34 ITR 368 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".

[24] Superficially, 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**".*

[25] The definition of "business" in Section 217 is, however, 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. In *Mr. S. P. Muttiah v. The Commissioner General of*

Inland Revenue CA/TAX/46/2019 decided on 30.07.2021, this Court held at paragraph 122:

> *"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".*

[26] 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**."*

[27] 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...

[28] 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. The Sinhala version of item 31 makes reference to an "**individual"** and thus, the Respondent could not offer any 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".*

[29] 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 ලංකාවේ දි පවත්වාගෙන යනු ලබන යම් ආයතනයක් ලාබ සහ ආදායමට අදාළව ආදායම් බදු අනුප්‍රමාණය...

[30] 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 Fifth Schedule to the Inland Revenue Act (*Mr. S. P. Muttiah v. The Commissioner General of Inland Revenue (supra) & Mrs. C.S.D.B. Mutunayagam (CA/TAX/48/2019, decided on 30.07.2021, paragraph 28)*.

[31] 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 **one economically independent and self-sustaining indivisible entity,** 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 (*Mr. S. P. Muttiah v. The Commissioner General of Inland Revenue* (supra, p. 129) & *Mrs. C.S.D.B. Mutunayagam (CA/TAX/48/2019, decided on 30.07.2021, paragraph 29)*. Hence, that part of the finding of the TAC, namely that the term "business" referred to in section 217 of the Inland Revenue Act is limited to activities of a company shall stand corrected.

Business income vs. Rental income

[32] 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 TAC however, did not rest its decision on the ground that the Appellant as an

individual could not be regarded as an undertaking. The TAC proceeded to consider the next crucial question whether the Appellant is involved in the activity of operating and maintaining facilities for storage. Having considered the second question, the TAC held on the facts, that (i) the Appellant is not engaged in operating and maintaining facilities for storage as required by item 31; and (ii) the income received by the Appellant by leasing out his premises for storage constitutes a rental income under Section 3 (g) and not a business income under section 3(a) of the Inland Revenue Act. For the said reasons, the TAC disallowed the tax concession sought by the Appellant under item 31 of the Fifth Schedule to the Inland Revenue Act.

[33] Now the question is whether the Appellant as one economically independent and self-sustaining indivisible entity carried on in Sri Lanka for operation and maintenance of facilities for storage. The last page of the determination made by the TAC at page 10 of the determination confirms this position. It reads:

> *"In this case, we have carefully considered the oral and written submissions of both the representatives for the Appellant and the Respondent. In view of the material stated above, it is clear that the Appellant is not involved in an undertaking or an activity of operating and maintaining facilities for storage. Therefore, the Appellant is not entitled to claim the 10% tax concession provided in the Fifth Schedule item 31 or under section 59B of the Inland Revenue Act."*

[34] Mr. Suren Fernando submitted that the phraseology "for operation and maintenance" of facilities for storage" in item 31 is different from "operating and maintaining" storage facility, but the phraseology should only be interpreted to apply to income derived from renting out of storage facilities. Mr. Fernando relied on the Sinhala version of the Inland Revenue Act and submitted that the intention of the legislature makes it clear that any undertaking that provides facilities for the purpose of the operation and maintenance of storage facilities is entitled to secure the concession under item 31. Hence, he argued that upon a reading of the Sinhala version of item 31, a wide interpretation should be given to item 31 of the Fifth Schedule so as to include rental income as well.

[35] The Sinhala version is reproduced herewith for clarity. It reads:

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

[36] In view of Mr. Fernando's submission that the tax concession is triggered where any undertaking that provides facilities for the purpose of operation and maintenance of storage facilities, and therefore, there is no further requirement for the undertaking itself to "operates and maintains" the storage facility, it is necessary to consider the difference between "operation" and "operating". According to Compact Oxford Thesaurus Dictionary (Indian Edition), 2001, as a noun, the word "operation" is:

1. The action of operating 2. An act of surgery performed 3. An organized action involving a number of people 4. A business organization 5. Math, a process in which a number of quantity, etc., is altered according to set formal rules.

2. control, direction, function, functioning, management, operating, performance, running, working, 2. Action, activity, business, campaign, effort, enterprise, exercise, manoeuvre, movement, procedure, proceeding, process, project, transaction, undertaking, venture; 3. Biopsy, surgery, transplant.

[37] According to Compact Oxford Thesaurus Dictionary (Indian Edition), 2001, as a verb, the word "operate" (operates, operating, operated) is:

1. function 2 control the functioning of (a machine) or the activities of (an organization) 3. (of an armed force) carry out military activities 4. Be in effect: *a powerful law operates in politics*. 5. Perform a surgical operation.
2. act, function, go, perform, run, work, 2. Control, deal with, drive, manage, use, work. 3. Do an operation, perform surgery.

[38] Thus, the word "operation" is the noun and the word "operating" is the verb. The word "operate" in relation to a storage facility is the function of a storage facility or control the functioning of a storage facility operation. The word "operation" in relation to a storage facility of an undertaking is the method by which such storage facility performs its function or activities it performs or action of operating such storage facility or running such facility.

[39] Similarly, the word "maintenance" of the noun and the word "maintain" is the verb. According to Compact Oxford Thesaurus Dictionary (Indian Edition), the word "maintain" is 1. Cause for continuance in the same state or at the same level. 2. Keep in good condition by checking or repairing it regularly. 3. support financially. 4. State strongly to be the case.

[40] The word "maintenance" is 1. The action of maintaining something. 2. The provision of financial support, conservation, looking after, repairs, servicing, upkeeping. Thus, maintenance *inter alia*, is the process of keeping things working and maintain *inter alia*, is to keep something working.

[41] P. M. Bakshi on Interpretation of Statutes First Edition, 2011 dealing with the construction of the meaning of words states at p. 496:

> *"The general rule of statutory construction of a fiscal statute is that words have to be construed strictly according to their ordinary and natural meaning, particularly when the statute is a fiscal one irrespective of the object with which the provisions was introduced. Of course, if there is ambiguity in the statutory language, reference may be made to the legislative intent to resolve the ambiguity. But if the statutory language is unambiguous, then that must be given effect to. The Legislature is deemed to intend and mean what it says. The need for interpretation arises only when the words used in the statute are, on their own terms ambivalent and do not manifest the intention of the Legislature. However, there are exceptions to this rule. The first is that the rule of strict construction does not apply to a provision which merely lays down the machinery for the calculation or procedure for the collection of tax. The second exception is: If two constructions are possible and a strict construction would lead to an absurd result then the construction which is keeping with the object of the statutory provision or in keeping with equity could be accepted".*

[42] It is a settled principle of law that in construing the relevant item or entry in fiscal statutes, if it is one of everyday use, the concerned authority must normally construe it, as to how it is understood in common parlance or in the commercial world or trade circles. This statement was amply described by Lord Esher in *Unwin v. Hanson* (1891) 2 QB 115 thus:

> *"If the Act is directed to dealing with matters affecting everybody generally, the words used have the meaning attached to them in the common and ordinary use of the language. 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".*

[43] There is no ambiguity in the statutory language of the words "operation" and "operates" or "maintenance" and "maintain" and the tax concession is provided to any undertaking viz, economically independent and self-sustaining indivisible entity that is functioning or performing activities of operating and maintaining facilities for storage.

[44] Mr. Fernando submitted that the Appellant is in the business of operation and maintenance of storage facilities and the income derived from renting out of storage facilities falls within the tax concession specified in item 31 of the Fifth Schedule. He further submitted that the TAC erred in relying on the lease agreements between the Appellant and the two parties but the said lease agreements are not a conclusive basis to determine that the Appellant was in the business of renting out properties instead.

[45] 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.

Whether the Appellant is operating and maintaining facilities for storage

[46] In order to earn the benefit under item 31 of the Fifth Schedule, 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.

[47] It is significant to note that the words "rate of income tax applicable to any undertaking" occurring in item 31 of the Act is qualified by the words "carried on in Sri Lanka for the 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 30 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** or 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.

[48] 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. It is relevant to note that 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

[49] 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 penalties 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). 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.

[50] 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."*

[51] 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 the operation and maintenance of facilities in respect of the three main purposes, namely, storage, development of software or supply of labour. The legislature advisedly used the words "for operation and maintenance of facilities for storage" because the intention of the legislature in granting the 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.

[52] 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....".

[53] 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. 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.

[54] 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.

[55] If the argument advanced by Suren Fernando that the Appellant is entitled to the exemption in terms of item 31 of the Fifth Schedule regardless of whether it operates the storage facilities, is correct, the words used 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.

[56] 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

[57] 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.

[58] 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.

Factors used in distinguishing rental income from business Income

[59] In order to determine whether, the Appellant 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. At this stage it is important to consider the distinction between the rental income and the business income from warehouse facilities provided to others by taxpayers, in the context of Indian case law that has addressed this issue.

[60] 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. 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.

[61] 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. 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 some 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 Tax Act".*

[62] 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".*

[63] 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.

[64] In *Atm a 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. The Court said that the rental income was received by the company 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*".

[65] Let me now consider the nature of the activity carried on by the Appellant and consider whether the income that is received was to be treated as income from the renting out of property or the income from the business of operation and maintenance of storage facilities specified in item 31 of the Fifth Schedule to the Inland Revenue Act. The Appellant is the precedent partner of a registered partnership “A. Valentine Trading Co.” and the Appellant’s Return of Income describes the nature of the partnership business as “letting premises for

commercial purposes" (page 45n of the TAC brief). Mr. Suren Fernando however, submitted that the ownership of the land or lease agreements are not conclusive to prove that the Appellant is engaged in the business of renting premises for storage facilities or engaged in the business of operation and maintenance of storage facilities. He submitted that what matters is the nature of the activity conducted by the Appellant.

[66] Sarkar, J. held in the Indian Supreme Court in *Sultan Brothers (P) Ltd. v. CIT* (1964) 51 ITR 353 (SC)/ 1964 AIR 1389, 1964 SCR (5) 807 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*".

[67] 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*(44 ITR 362 (SC). The Indian judgments have thus, 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 *Sutan Brothers (P) Ltd. v. CIT*(supra).

[68] 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 he 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 operating and maintaining facilities for storage.

[69] The Appellant has submitted that he had inherited 5 warehouses from his father and constructed three more, and thereafter continued to provide storage facilities in those warehouses to customers, in the same manner that his father had done without any lease agreement but only a memorandum of understanding. He has further submitted that upon the request made by the Department of Inland Revenue, the Appellant executed lease agreements for the premises and the Department of Inland Revenue is now using the said lease agreements as a basis to deny the due tax concession. The Appellant's argument was that the material submitted by the Appellant demonstrates that he in fact operates and maintains the storage facilities and therefore, the Appellant is entitled to the exemption in terms of item 31 of the Fifth Schedule to the Inland Revenue Act.

[70] The learned Deputy Solicitor 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 and the facts relied on by the Appellant indicate that the Appellant was merely providing a storage facility to others and collecting a rent, which are insufficient for the eligibility under item 31 of the Fifth Schedule. He further submitted that no credible evidence had been placed by the Appellant to establish that he 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 TAC.

[71] It is not in dispute that the Appellant has entered into lease agreements with Cargills Retail (Private) Limited and Ranfer Teas (Private) Limited and leased out his premises to Cargills Retail (Private) Limited (p. 184 of the TAC brief) and Ranfer Teas (Pvt) Ltd (p. 172 of the TAC brief). The Appellant relies on the following two clauses of the said two lease agreements with Cargills Retail (Private) Limited and Ranfer Teas (Private) Limited, and argues that they indicate that the Appellant was responsible for the maintenance of the premises and that the TAC was wrong in holding that the Appellant was only renting warehouses to the parties based only on the existence of written lease agreements:

[72] Paragraph 4(m) of the lease agreement with Cargills Retail (Private) Limited states:

"(m). To permit the lessors and their agents, engineers, workmen and other person authorized in writing after due notice to the lessee to enter upon the demised premises at all reasonable times during the day time to view and examine the state of repair and condition thereof without causing any inconvenience or disturbance to the lessee or its customers and for the purpose of effecting any repairs to the demised premises in accordance with the prior agreement with the Lessor's covenants. Such repairs to be effected with the prior agreement and arrangement of the Lessee so as to cause as little inconvenience and disruption to the smooth running of the Lessee's business".

[73] Paragraph z(3) of the lease agreement with Ranfer Teas (Private) Limited states:

"z3.To permit the Lessors and their agents and their agents engineers workmen and other persons authorized by the Lessors in writing with or without workmen after three (03) days previous notice in writing at all reasonable times during the day convenient to the Lessee to enter upon the demised premises to inspect the same and to carry out any kind of repairs undertaken by the lessors in terms hereof and in so doing to cause as little inconvenience as possible to the occupants of the demised premises".

[74] The Appellant's argument was that the lease agreements establish that the Appellant effected repairs of the premised in question. A perusal of a perusal of the following clause 2(l) of the lease agreement with Cargills Retail (Pvt) Ltd and clause 2(f) of the lease agreement with Ranfer Teas (Pvt) Ltd however, indicate that the day-to-day running repairs of the premises were to be carried out by the lessees and not by the Lessors:

[75] Clause 2(l) of the lease agreement with Cargills Retail (Pvt) Ltd states

2(l). To repair or cause to be repaired at the cost and expense of the lessee all damages to the demised premises or any part thereof including damages to the structure of the demised premises which may be caused due to the negligence on the part of the lessee its servants, agents, licensees and invitees and all repairs the cost of which shall not exceed the sum of Rupees Five Thousand (Rs. 5000.00) at any one time except repairs due to structural defects and faulty construction".

[76] Clause 2(f) of the lease agreement with Ranfer Teas (Pvt) Ltd states:

2(f). To carry out the repairs excluding structural repairs to the demised premises and the fixtures and fittings therein not exceeding Rupees Ten Thousand (Rs. 10,000/) at any one time unless such structural repairs or

repairs in excess of Rupees Then Thousand (Rs. 10,000/) are necessitated by any negligent or willful act on the part of the lessee or other occupants of the demised premises".

[77] A perusal of clause 2(i) of the lease agreement with Cargills Retail (Pvt) Ltd and clause 2(n) of the lease agreement with Ranfer Teas (Pvt) Ltd reveals that the obligation to install firefighting equipment and maintain such equipment in good working order at cost and expense was on the lessee and not on the lessor. Clause 2(i) of the lease agreement with Cargills Retail (Pvt) Ltd states:

"(i)To install all the cost and expense of the lessee fire fighting equipment in the demised premises and maintain such equipment in good working order".

[78] Clause 2(n) of the lease agreement with Ranfer Teas (Pvt) Ltd states:

"(n) The lessee shall at its cost install in the demised premises and maintain in good working order adequate firefighting equipment and appliances to the satisfaction of the Fire Brigade Department, Ja-Ela Pradeshiya Sabha Ministry of defence or any other Authority specifically by law during the currency of this lease".

[79] A perusal of clause 2(n) of the lease agreement with Cargills Retail (Pvt) Ltd and clause 2(g) of the lease agreement with Ranfer Teas (Pvt) Ltd reveals that the obligation to remove garbage accumulated in the demised premises and keep the storage premises in a clean and sanitary state and order was the responsibility of the lessee and not the lessor. Clause 2(n) of the lease agreement with Cargills Retail (Pvt) Ltd states:

"(n) To be responsible for the timely removal of the garbage accumulated in the demised premises and not to place garbage bins on Lot 1D depicted in the said Plan No. 6328 (reservation for road)".

[80] Clause 2(g) of the lease agreement with Ranfer Teas (Pvt) Ltd states:

"(g) To keep the demised premises in a clean and sanitary state order and condition and in strict accordance with the laws by laws of the Ja-ela Pradeeshiya Sabha, Western Province Provincial Council, the Urban Development Authority or any other State Authority and to keep the lessors freed from and indemnified against from all prosecutions and fines which may be instituted or imposed in consequence of the breach or non-performance of any laws or by-laws respecting housing sanitation and conservancy".

[81] A perusal of clause 2(p) of the lease agreement with Cargills Retail (Pvt) Ltd and clause 2(z) of the lease agreement with Ranfer Teas (Pvt) Ltd reveals that the obligation to provide security to the demised premises continuously day

and night, during the term of the lease is on the lessee and not on the lessor. Clause 2(p) of the lease agreement with Cargills Retail (Pvt) Ltd states:

> *"(p) To provide security to the demised premises continuously day and night during the said term".*

[82] Clause 2(z) of the lease agreement with Ranfer Teas (Pvt) Ltd:

> *"(z). To employ or engage day and night separate security services for the safety of the contents of the demised premises".*

[83] A perusal of clause 2(h) of the lease agreement with Cargills Retail (Pvt) Ltd and clause 2(p) of the lease agreement with Ranfer Teas (Pvt) Ltd reveals that the obligation to insure the goods and equipment in the demised premises against loss or damage by terrorism, fire, flood, lightning, cyclone storm or explosions and riot commotion of war was on the lessee and not on the lessor. Clause 2(h) of the lease agreement with Cargills Retail (Pvt) Ltd states:

> *"(h) To insure and keep insured the lessee's goods and equipment in the demised premises against loss or damage by terrorism fire flood lightning cyclone storm, tempest explosions, riots, civil commotion, war, labour disturbances and any malicious damages and/or any risk whatsoever and submit to the lessor copies of the said insurance so effected".*

[84] Clause 2(p) of the lease agreement with Ranfer Teas (Pvt) Ltd:

> *"(P) To insure and keep insured lessee's goods and equipment in the demised premises against loss or damage by terrorism, fire, flood, lighting, cyclone, storm, tempest explosions, riots, commotion, war".*

[85] A perusal of clause 5(i) of the lease agreement with Cargills Retail (Pvt) Ltd reveals that the obligation to install a generator, air conditioning units, chillers and water motors at the premises was the obligation of the lessee and not the lessor:

> *"5(i) To install at the cost and expense of the lessee firefighting equipment in the demised premises and maintain such equipment in good working order".*

[86] A perusal of clause 3(g) of the lease agreement with Cargills Retail (Pvt) Ltd reveals that the obligation to obtain a three-phase electricity connection of 100 amps to the demised premises with a separate meter for the exclusive use of the lessee was the responsibility of the lessee and not the lessor:

"3(g). To permit the lessee to obtain of the cost install a generator, air conditioning units, chillers and water motors at the premises was the obligation of the lessee and not the lessor".

[87] The Appellant further submitted the following documents exchanged between the Appellant and the lessees/occupiers establish that the Appellant was involved in the business of operation and maintenance of storage facilities:

1. (a) Letter from the Appellant to Cargills (Ceylon) Limited relating to invoicing for the year 2011 (p. 189 of the TAC brief);

   (b)Letters from the Appellant to George Steuarts (Teas and Marketing) (PVT) Limited relating to invoicing for the years 2010-2012 (p. 186-187);

   (c) A letter from George Steuart Teas to the Appellant relating to the Maintenance of warehouses (p. 185);

   (d) Lease agreement between the Appellant and Cargills retail (Private) Limited (p.184);

   (e) Lease agreement between the Appellant and Ranfer Teas (Private) Limited (p.172).

2. The Appellant's letters to A. Valentine Trading Co. and George Steuart Teas demonstrate that the Appellant operated and maintained the warehouses and therefore, the actual relationship between the parties is established by the content of the said letters and not by the standard clauses of the lease agreement;

[88] The letters sent to Cargills (Pvt) Ltd by the Appellant (p. 189 of the TAC brief) and the letter sent to George Steuarts (Teas and Marketing) (Pvt) Ltd (p. 186 & 187 of the TAC brief) only refers to the change in the rental amount and the need to enter into a formal lease agreement. Those two letters do not establish whatsoever, that the Appellant was involved in the business of operation and maintenance of storage facilities. The letter from George Steuart Teas to the Appellant relates to a request to make the following repairs in connection with another warehouse (54/2A, 54/2B in Mattakkuliya) to the roof, floor and colour washing and supply of electricity before George Steuart Teas occupied the said warehouse. No agreement or lease agreement or any document has been produced by the Appellant to substantiate the position that the Appellant was involved in the **operation and maintenance of the warehouse No. 54/2A, 54/2B** situated in Mattakkuliya.

[89] The letter sent to George Steuarts (Teas and Marketing) (Pvt) Ltd also relates to the increase in rental for the premises at No. **54/1B & 54/2**, Centre Road, Colombo 15 and the need to enter into a lease agreement (p. 188 of the TAC brief). The Appellant however, relies on the following statements of the said letter and argues that they establish that the Appellant was involved in the business of operation and maintenance of storage facilities.

> *"Due to the rise in the cost of maintenance of the buildings and roadways and the increase in the Assessment Taxes by the CMC of 26%, we are compelled to increase the rentals. As you are also aware that Sri Lanka's inflation was over 25% IN 2008 and that cost of construction materials and labour has risen above 30% to 40% in the past few years, we are compelled to make these increases.*
>
> *As always, we will maintain the warehouses to be in good condition so that you can carry out your business of Tea Exporting without any interruptions and delays".*

[90] Apart from the mere statement of the Appellant that "we will maintain the warehouses to be in good condition so that you can carry out your business of Tea Exporting without any interruption and delays", no supporting document or lease agreement has been produced by the Appellant to substantiate the position that the Appellant was involved in the **operation and maintenance of the warehouse No. 54/1B, 54/2**. situated in Mattakkuliya.

[91] From the details furnished in the brief, it appeared that apart from constructing buildings to be used as warehouse facilities and leasing them out to several companies subject to common terms and conditions set out in those lease agreements, no credible material has been placed by the Appellant to show that he 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 his lessees (Cargills Retail (Pvt) Ltd and Ranfer Teas (Pvt) Ltd) or George Steuarts (Teas and Marketing) (Pvt) Ltd during the year 2011/2012.

[92] A perusal of lease agreements contained in the brief reveals that apart from basic ancillary services such as water and electricity provided to lessees, there had been no central air conditioning provided to each store and the users are responsible for the installation of their own air conditioners in respective

premises, and other electrical appliances, firefighting equipment, fire appliances to their respective premises 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 of the brief).

Affidavit of the Appellant

[93] At the hearing, Mr. Suren Fernando strenuously argued that as the Appellant produced an Affidavit marked as "Annexure 01" to the final written submissions (p. 111 of the brief) before the TAC, the burden was on the Respondent to disprove it or establish facts to dispute the contents of the affidavit. He submitted that the Respondent did not object to the admissibility of the Affidavit at any stage either in the proceedings before the TAC or in its written submissions or sought to cross examine the Appellant on the Affidavit or lead evidence to contradict same. He submitted that the TAC by not rejecting the Affidavit produced by the Appellant before it, allowed, by implication, the Appellant to adduce evidence through the Affidavit in terms of section 9(8) of the TAX Appeals Commission Act, No. 23 of 2011 (TAC Act) without any objection and therefore, the admissibility of the Affidavit cannot be raised at this stage of the appeal by the Respondent after the Affidavit became part of the record.

[94] The contention of Mr. Fernando was that the Appellant had placed uncontradicted Affidavit evidence as to the nature of the business and discharged his burden of proof whereas the Respondent failed to contradict the Appellant through cross examination or leading of evidence to dispute same. On the other hand, Mr. Jayasinghe submitted that the TAC was correct in not relying on the Affidavit of the Appellant produced with his written submissions without the consent of the TAC as required by section 9(8) of the TAC Act. He further submitted that the TAC acted correctly in relying on the contents of the lease agreements to the exclusion of the Appellant's Affidavit, based on the parol evidence rule found in section 92 of the Evidence Ordinance, to determine that the Appellant did not engage in the operation and maintenance of facilities for storage that he was involved in the operation and maintenance of the warehouses

[95] A perusal of the TAC brief reveals that the Appellant annexed an Affidavit (Annexure 1) to his written submissions dated 07.01.2020 (pp. 111 & 100 and

97-99 of the TAC brief). The Appellant relies on paragraphs 3, 7, 8, 9, 10, 11, 12, 13, 14, 15 and 16 and 17 of the Affidavit to establish that the Appellant was engaged in operating and maintaining storage facilities and provides other ancillary facilities to his lessees. A perusal of the TAC brief reveals that the Appellant annexed the Affidavit in question to his written submissions before the TAC without obtaining the TAC's consent or permission, in contravention of the provision of section 9(8) of the TAC Act. Section 9(8) of the TAC Act, as amended by the TAC (Amendment) Act, No. 20 of 2013 provides:

> *"**Except with the consent of the Commission and on such terms as the Commission may determine, the appellant shall not at the hearing, be allowed to produce any document which was not produced before the Commission-General or the Director-General**, as the case may be, or to adduce the evidence of any witness whose evidence was not led before the Commissioner-General or the Director-General as the case may be, or adduce evidence of a witness whose evidence has already been recorded at the hearing before the Commissioner-General or the Director-General, as the case may be".*

[96] The TAC brief does not indicate that any request had been made by the Appellant to the TAC seeking permission to produce the Affidavit in question, or an order was made by the TAC permitting the Appellant to produce the Affidavit before the TAC. Under such circumstances, the TAC cannot be faulted in not making any reference to the said Affidavit or relying on the averments contained in the Affidavit produced by the Appellant without its consent.

[97] The Appellant is relying on the following main facts in the Affidavit to establish that his partner was engaged in operating and maintaining storage facilities and in order provide storage facilities to the customers, the partnership took the following steps:

1. The partnership recruited and employed the staff including a Manager, Supervisor, skilled labour in carpentry, steel fabrication and repairs, welding and gas cutting, construction machine operators, masons and other labourers;
2. The partnership acquired necessary property, plant and equipment including crew, cab vehicles, mini lorries, vans, construction equipment to repair and maintain the facilities so that the goods of the customers could be stored without any damage or hindrance;

3. The partnership employed as a security officer who was entrusted with the security of the premises;
4. The partnership attends to any situation that arises due to natural and man-made emergencies;
5. When there is a storm or heavy rains with high winds causing damages to the roofing sheets or the roof structure, the partnership dispatches a team to attend and repair the same within a few hours so that there is no water damage to the building;
6. When a container or lorry that came to load or unload the goods has damaged the warehouse gate or wall or roadway and cannot close the warehouse large doors or making a big hole in the roadway, the partnership dispatches an emergency repair team/a crew consisting of workers of the partnership and at times, specialized skilled workers to repair the damage or repair the roadway;
7. When there is a damage to a water pipeline or electrical connection due to an accident, the partnership works with the Water Board and Electricity Board in rectifying and repairing the problem;
8. The Partnership upgrades and renovates the storage facilities enabling the customers to obtain the approvals from the authorities;
9. The partnership provides electricity and water facilities and pays the bills to the CEB and the Water Board;
10. Warehouse and Storage premises are insured by the partnership and the taxes are paid to the authorities.

(Vide-paragraphs 3, 7, 8, 9, 10, 11, 12, 13, 14, 15 and 16 and 17 of the Affidavit).

[98] The Appellant's Affidavit does not contain any documentary proof to substantiate the averments contained in the aforesaid paragraphs and, in particular there is no proof whatsoever to the effect that:

1. The Appellant recruited and employed the staff including a Manager, Supervisor, skilled labour in carpentry, steel fabrication and repairs, welding and gas cutting, construction machine operators, masons and other labourers;
2. The Appellant acquired necessary property, plant and equipment including crew, cab vehicles, mini lorries, vans, construction equipment to repair and maintain the facilities so that the goods of the customers could be stored without any damage or hindrance;

3. The Appellant employed a security officer who was entrusted with the security of the premises or employed any skilled workers to attend to any situation that arises due to natural and man-made emergencies;
4. The Appellant employed or recruited a skilled team or emergency or specialized skilled workers to attend and repair works of the premises within a few hours;
5. The entire warehouse and individual storage premises are insured by the Appellant contrary to the contents of the lease agreement that provides that the lessee must insure its own goods and equipment in the premises;
6. The Appellant installed a generator to the entire storage facilities and provided security to the entire storage facilities when the lease agreements provide that the lessees must install their own generators and their own security continuously day and night;

[99] As noted, there is no credible evidence placed by the Appellant to establish that the Appellant operated and maintained the warehouse facilities by providing central air conditioning to each premises, firefighting equipment, central generator facility, day and night security services, garbage collection by employing a Manager/Supervisor/skilled workers/ society personnel, technical and mechanical staff.

[100] 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 in 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. 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 he 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.

[101] Accordingly, in the absence of such credible and supporting documentary proof, the TAC was correct in relying on the contents of the lease agreements

to determine that the Appellant did not engage in the operation and maintenance of facilities for storage except to provide ancillary services to the warehouses such as water and electricity,

[102] In *Griffiths v. Jackson* (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."*

[103] 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."*

[104} The Appellant has not placed any credible material to satisfy that the nature of the leasing out his 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 and providing ancillary services. 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.

[105] 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 *implicitor* 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. For those reasons, I am of the view that the Appellant has failed to establish that that the Appellant is an undertaking, viz, one economically independent and self-sustaining indivisible entity engaged in the operation and maintenance of facilities for storage as required by item 31 of the Fifth Schedule to the Inland Revenue Act.

[106] 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 his warehouses in the year under consideration cannot be treated as a business income but only as a rental income as correctly determined by the TAC. For those reasons, the income received by the Appellant from leasing out his 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 TAC.

Question of Law No. 3

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?

[107] The contention of Mr. Suren Fernando was that in any event, the Appellant was entitled to the concessionary tax rate of 10% as provided in section 59B of the Inland Revenue Act, in view of the fact that the turnover of the undertaking was less than rupees three hundred million in the relevant year and assessment. The learned Deputy Solicitor General however, submitted that the mere letting out of a building or premises to be used as a storage facility as opposed to trade/business income under section 3(a) cannot amount to the provision of a service by an undertaking as contemplated by section 59B of the Act. He submitted, therefore, that the Appellant is disentitled from obtaining the concession in terms of section 59B (1) and (2) of the Inland Revenue Act.

[108] Section 59B (1) and (2) of the Inland Revenue Act reads as follows:

"(1) The profits and income of any person (not being the holding company, a subsidiary company, or as associate company of a group of companies) for any year of assessment commencing on or after April 1, 2011, from any understanding referred to in subsection (2), shall, notwithstanding anything to the contrary in any other provisions of this Act, but subject to provisions of section 59B, be chargeable with income tax at the appropriate rate specified in the Fifth Schedule to this Act.

(2) 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".

[109] 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.

[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. 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 his 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. The ancillary services provided by the Appellant as referred to in the lease agreements are directly connected to his 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.

[114] 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 music or dancing entertainments and the owners had equipped the rooms so as to make them available for those purposes.

[115] 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".

[116] 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 his tenants to be regarded as a separate service income. The mere fact that the Appellant is providing storage facilities with ancillary services to his 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.

[117] Having regard to the totality of the circumstances and to the true substance of the agreements, I hold that the Appellant is not an undertaking within the meaning of section 59B of the Inland Revenue Act. Therefore, 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.

Questions of Law No. 5 and 6

5-Is the assessment (and the determination of the Commissioner-General and the determination of the Tax Appeals Commission, thereon) excessive and contrary to law?

6-In view of the evidence and material before the Tax Appeals Commission, did the Tax Appeals Commission err in law in arriving at the conclusion set out in its determination?

[118] No separate submission was made on behalf of the Appellant at the hearing that the assessment (and the determination of the Commissioner-General and the determination of the Tax Appeals Commission, thereon) was excessive and contrary to law other than the submissions made on behalf of the Appellant relating to the questions of law No. 2 and 3. I further hold that subject to our observations in paragraph 31 of this judgment, the TAC did not err in law in arriving at the conclusion set out in its determination dated 11.11.2021.

Conclusion & Opinion of Court

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

1. Does not arise as the Appellant did not pursue the question of law No. 1 at the hearing.
2. No.
3. No
4. Does not arise as the Appellant did not pursue the question of law No. 4 at the hearing.
5. No.
6. No.

[120] For those reasons stated in this judgment and subject to our findings in paragraph 31 of this judgment, the final determination made by the Tax Appeals Commission dated 11.11.2021 is confirmed. The Registrar is directed to send a certified copy of this judgment to the Tax Appeals Commission.

JUDGE OF THE COURT OF APPEAL

<u>M. Sampath K.B. Wijeratne, J.</u>

I agree.

JUDGE OF THE COURT OF APPEAL