IN THE COURT OF APPEAL OF THE DEMOCRATIC

SOCIALIST REPUBLIC OF SRI LANKA

In the matter of a Stated Case on question of law for the opinion of the Court of Appeal under and in terms of section 122 (2) of the Inland Revenue Act, No. 28 of 1979.

SriLankan Airlines Limited,
Airline Centre,
Bandaranaike International Airport,
Katunayake.
Appellant

Case No. CA/TAX/0002/2010
Tax Appeals Commission
No. BRA-523/SCA-226

Vs.

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

Before	**:**	Dr. Ruwan Fernando J. &
		M. Sampath K.B. Wijeratne J.
Counsel:	**:**	Dr. Shivaji Felix with Nivantha
		Satharasinghe for the Appellant
		Manohara Jayasinghe, D.S.G. for the
		Respondent.
Argued on	**:**	10.09.2023 & 19.10.2022

Written Submissions filed on :

: 06.02.2023& 01.11.2019 (by the Appellant)

06.02.2023 & 11.03.2016 (bythe Respondent)

Decided on : 28.02.2023

Dr. Ruwan Fernando, J.

Introduction

[1] This is an appeal by way of a case stated against the determination of the Board of Review dated 22.10.2009 confirming the assessment made by the assessor subject to variation with regard to the interest received from the Bank of Ceylon as exempt interest under and in terms of section 10(g) of the Inland Revenue Act, No. 28 of 1979 (as amended). The years of assessments related to the appeal are 1994/1995 and 1995/1996.

Factual Background

[2] The Appellant is a limited liability and is operating its business as a commercial airline providing international air transportation and all other related services thereto. The Appellant entered into an Agreement with the Board of Greater Colombo Economic Commission (hereinafter referred to as the GCEC) under the Greater Colombo Economic Commission law, No. 4 of 1978 and Supplementary Agreements under its successor, the Board of Investment of Sri Lanka under the Board of Investment of Sri Lanka Law, No. 4 of 1978 as amended (hereinafter referred to as the BOI). In terms of clause 8 of the Agreement No. 972 dated 28.01.1982 with the GCEC, the provisions of the Inland Revenue Act, No. 28 of 1979 relating to the imposition and collection of income tax in respect of profits and income of the Enterprise shall not apply for a period of 7 years reckoned from the date of commencement of commercial operations of the said business as may be determined by the BOI. In terms of the Supplementary Agreement No. 25 with the BOI, the tax exemption was extended to ten years from the date of which the enterprise is deemed to have commenced commercial operations. In terms of the Supplementary Agreement, No. 184 with the BOI, the said period was extended to fifteen years reckoned

from the year of assessment 1983/1984. During the said tax exemption period, the said Agreements provided that the provisions of the Inland Revenue Act, No. 28 of 1979 relating to the imposition, payment and recovery of income tax in respect of profits and income of the Enterprise shall not apply to the profits and income of the Enterprise.

[3] The Appellant filed the return of income with the Department of Inland Revenue for the years of assessment 1994/95 and 1995/96 claiming (i) the exemptions from interest income of Rs. 97,662,847/- for the year of assessment 1994/1995 and Rs. 67,498,917 for the year of assessment 1995/1996; (ii) the deduction of losses from the previous years amounting to Rs. 192,464,632/- for the year of assessment 1994/95 and Rs. 88,236,047/- for the year of assessment 1995/96; and (iii) exemption of interest accrued to deposits made in foreign currency accounts under section 10(g) of the Inland revenue Act, No. 28 of 1979. The assessor by his letters rejected the returns furnished by the Appellant for the following reasons:

1. Business profits fall under section 3(a) and interest income and rental income falls under section 3(e) and 3(g) of the Inland Revenue Act respectively;

2. The exemption from income tax has been granted to the Appellant under clause 8 of the agreement for its business profits which fall under section 3(a) of the Inland Revenue Act. No exemptions have been granted in respect of interest income and rental income which fall under section 3(g) of the Inland Revenue Act;

3. Brought forward loss consists of pre-operational interest incurred in connection with the acquisition of air crafts which were not put into operation during the year of assessment, and such pre-operational interest is in respect of the loans for the acquisition of aircrafts for the enterprise. The aircrafts have been acquired by the Appellant for the enterprise of operating a business of commercial airline and therefore, the brought forward loss consisting of interest is not deductible either under section 23 or 29 of the Inland Revenue Act.

[4] Accordingly, the Assessor assessed the Appellant and computed the assessable income as follows:

	Y/A 1994/95	Y/A 1995/96
Interest	97,662,847	67,498,917
Rent	455,000	499,473
Statutory Income	98,117,847	67,498,917

Appeal to the Commissioner-General of Inland Revenue & Referring the appeal to the Board of Review

[5] Being dissatisfied with the said assessments, the Appellant appealed against the assessments to the Commissioner-General of Inland Revenue by petition of appeal dated **25.05.1998** for the year of assessment 1994/1995 and by petition of appeal dated **23.03.1999** for the year of assessment 1995/1996. By letter dated **15.06.2001**, the Respondent informed the Appellant that the appeals were referred to the Board of Review (hereinafter referred to as the BOR) in terms of section 120 of the Inland Revenue Act, No. 28 of 1979. The main issues before the Board of Review were:

1. Whether the appeals had been concluded by operation of law containing the Inland Revenue (Special provisions) Act, No. 10 of 2003 and the Interpretation Ordinance, No. 21 of 1901 (as amended);

2. Whether the appeals are time barred in terms of section 140(10) of the Inland Revenue Act, No. 28 of 1979 as amended by the Inland Revenue (Amendment) Act, No. 08 of 2000 and the Inland Revenue (Amendment) Act, No. 37 of 2003;

3. Whether the year of assessment 1994/1995 had become statute-time barred before it was referred to the Board of Review by operation of section 117 (12) of the Inland Revenue Act, No. 28 of 1979;

4. Whether the interest income received by the Appellant from short term call deposits and utilized for the working capital requirements of the business constitutes part of the exempt profits within the contemplation of the Agreement entered into with the Board of Investment of Sri Lanka under the BOI Law;

5. Whether the preoperational interest costs are claimable deductions under section 29 of the Inland Revenue Act, No. 28 of 1979 (as amended);

6. Whether the interest income accrued to the Appellant from deposits made in foreign currency accounts of the Bank of Ceylon in a sum of Rs. 47,945,862/- is an exempt income in terms of section 10(g) of the Inland Revenue Act, No. 28 of 1979 (as amended).

[6] The BOR answered all the issues referred to in 1-3 above in favour of the Commissioner-General and refused to grant the exemption of interest income from the application of the Inland Revenue Act, No. 28 of 1979 (issue No. 4) on the ground that (i) the interest income claimed falls within the contemplation of the Agreement entered into with the BOI; and (ii) the Appellant has failed to establish that the funds of the accounts have been used for the purpose of the business or employed or risked in the business forming interest as an integral part of the business of the enterprise for which the exemption is applicable.

[7] The BOR further refused to grant the Appellant's claim under section 29 of the Inland revenue Act, No. 28 of 1979 and held that preoperational interest costs are not deductible. The BOR however, varied the amounts assessed by allowing the interest income accrued to the Appellant from deposits made in foreign currency accounts in a sum of Rs. 47,945,862/- and received from the Bank of Ceylon as exempt interest under section 10(g) of the Inland Revenue Act, No. 28 of 1979 (as amended).

Questions of Law for the Opinion of the Court of Appeal

[8] 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:

(a) Were the assessments referred to in this appeal already revised or concluded to be final and conclusive in terms of section 4 (3) of the Inland Revenue (Special Provisions) Act, no 10 of 2004 and section 6 (3) of the Interpretation Ordinance No. 2 of 1901 (as amended)?

(b) Was the appeal already statutorily barred for the hearing and determination owing to the fact that two years' limit provided by the proviso to section 140 (10) of the Inland Revenue Act No 38 of 2000 as amended by Inland Revenue (Amendment) Act No 37 of 2003 had lapsed before the present hearing commenced and concluded?

(c) Was the Board of Review prevented from hearing the appeal in respect of the year of assessment 1994/95 in view of the fact that it had already been determined by operation of law in terms of the imperative provisions of section 117 (12) of the Inland Revenue Act, No 28 of 1979?

(d) Has the Board of Review erred in law by coming to the conclusion that the funds in the accounts were not employed or risked in the business and the conclusion of the Board is contrary to the evidence available?

(e) Did the Board of Review err in law by disallowing the claim under Section 29 of the Inland Revenue Act No 28 of 1979?

[9] At the hearing of the appeal, Dr. Shivaji Felix, the learned Counsel for the Appellant and Mr. Manohara Jayasinghe, the Deputy Solicitor General for the Respondent made extensive oral submissions on the five questions of law submitted for the opinion of the Court.

Analysis

Question of Law, No. (a)

Do the section 4(3) of the Inland Revenue (special Provisions) Act), No. 10 of 2004 and the section 6(3) of the Interpretation Ordinance No. 2 of 1991 (as amended) have the effect of the making the assessments under appeal final and conclusive?

[10] At the hearing, Dr. Shivaji Felix submitted that the Appellant has not sought a tax amnesty under the provisions of the Inland Revenue (Special Provisions) Act, No. 10 of 2003 and the appeal before the Board of Review (hereinafter referred to as the "BOR") was a tax in dispute as contemplated by section 13 of the Inland Revenue (Special Provisions) Act, No. 10 of 2003 since the assessments have not been accepted by the Appellant as a person in concerned. He further submitted that accordingly, the tax specified by the Appellant in its return, as being the amount of tax payable by it, must be accepted by the Department of Inland Revenue as being correct and reflecting the final tax liability of the Appellant in respect of the period in issue as contemplated by section 4(3) of the Inland Revenue (Special Provisions) Act, No. 10 of 2003.

[11] Dr. Felix further submitted that section 4(4) of the Inland Revenue (Regulation of Amnesty) Act, No. 10 of 2004 does not encompass taxes in

dispute that has been settled by an appellate tribunal or the appeal was pending before the BOR, the Court of Appeal or the Supreme Court as the tax in dispute has not been crystallized and the assessments are not yet final and conclusive. He further submitted, therefore, that section 2(2) of the Inland Revenue (Regulation of Amnesty) Act, No. 10 of 2004 cannot be engaged in respect of a taxpayer who is disputing the tax liability.

[12] The question that arises for determination is (i) whether or not the assessments under appeal have been concluded to be final and conclusive in terms of section 4(3) of the Inland Revenue (special Provisions) Act, No. 10 of 2003 read with section 6(3) of the Interpretation Ordinance, No. 10 of 2004; and (ii) whether or not, the effect of section 4(3) of the Inland Revenue (special Provisions) Act, No. 10 of 2003 has been negated or nullified by section 4(4) of the Inland Revenue (Regulation of Amnesty) Act, No. 10 of 2004.

[13] Section 4(3) of the Inland Revenue (special Provisions) Act, No. 10 of 2003 provides as follows:

> *"Where there is any tax in dispute under any of the laws specified in the Schedule hereto, pertaining to tax, in respect of any period ending on or before March 31, 2000,* ***in relation to a person who has not made a declaration in terms of section 2,*** *then the tax specified by such person, as being the amount of tax payable by him shall be accepted by the relevant authority, charged with the administration of the laws specified in the Schedule hereto, as being correct and reflecting the final tax liability of that person in respect of such period :*
>
> *Provided that no tax in dispute, which has been settled with the agreement of the person who has not made the declaration in terms of section 2, shall be re-opened.*

[14] The term "tax" in section 13 of the Inland Revenue (Special Provisions) Act, No. 10 of 2003 shall include any tax, levy, penalty (including any penalty in respect of any offence), forfeiture or fine, payable or levied under any of the laws referred to in the Schedule to the said Act. Section 13 of the Inland Revenue (Special Provisions) Act, No. 10 of 2003 defines the phrase "tax in dispute" as follows:

> *"Tax in dispute" shall include any tax assessed under any of the laws referred to in the Schedule to this Act which has not been accepted by the Commissioner General, the relevant authority or the person concerned".*

[15] Section 4(3) of the Inland Revenue (Special Provisions) Act, No. 10 of 2003 applies where there is any **tax in dispute** under any of the laws specified in the Schedule (here, the Inland Revenue Act, No. 28 of 1979) pertaining to income tax, in relation to a person **who has not made any declaration** in terms of section 2 of the said Act, such as the Appellant). The provision of section 4(3) provides that the tax in dispute specified by such person shall be accepted by the relevant authority as per definition in section 13, as being correct and reflecting the final tax liability of that person.

[16] The assessments under appeal relate to the tax in dispute which has been assessed by the assessor in terms of the provisions of the Inland Revenue Act, No. 28 of 1979. No determination has been made by the Commissioner-General as the appeals filed by the Appellant against the said assessments were referred to the BOR by the Commissioner-General on 08.06.1998 (See-BOR determination, p.1). There is nothing to indicate, however, in section 4(3) on the Inland Revenue Special Provisions) Act, No. 10 of 2003 that the scope of this provision does not apply to assessments which have been appealed to the Commissioner-General, or the BOR or the Court of Appeal or the Supreme Court.

[17] In my view, section 4 (3) of the Inland Revenue (Special Provisions) Act, No. 10 of 2003 applies to the assessments under appeal which had been made by the assessor in terms of the provisions of the Inland Revenue Act, No. 28 of 1979 (as amended), whether or not a declaration seeking an amnesty was made by the Appellant to the Commissioner-General in terms of the provisions of the said Act, No. 10 of 2003. Significantly, by virtue of section 4 (3) of the Inland Revenue (Special provisions) Act, No. 10 of 2003, the Department of Inland Revenue was statutorily obliged to accept the tax specified by the Appellant in the return as being correct and reflecting the final tax liability of that person in respect of such period, 1994/1995 and 1995/1996.

[18] The appeals which were filed against the assessments in question were referred to the BOR by the Commissioner General on 08.06.2001 and by letter dated 15.06.2001, the Appellant was informed accordingly. When the Inland Revenue Special Provisions) Act, No. 10 of 2003 came into effect on **17.03.2003**, the appeals of the Appellant were pending before the BOR. The appeals before the BOR appear to have been discontinued on the basis of section 4(3) of the Inland Revenue (Special Provisions) Act, No. 10 of 2003.

[19] The Inland Revenue (Regulation of Amnesty) Act, No. 10 of 2004 was enacted by parliament and it came into effect on **20.10.2004**. This Act was designed to regulate the tax amnesty in respect of the non-payment or non-disclosure of liability under the provisions of the Inland Revenue (Special Provisions) Act, No. 10 of 2003 and to repeal the Inland Revenue (Special Provisions) Act, No. 10 of 2003. The title of the Inland Revenue (Regulation of Amnesty) Act, No. 10 of 2004 reads as follows:

> *"An act to provide for the regulation of the grant of an amnesty in respect of the non-payment or non-disclosure of liability to pay income tax in respect of declarations made on or before August 31, 2003 in terms of the repealed Inland Revenue ((Special Provisions)) Act, No. 7 of 2002 and the Inland Revenue ((Special Provisions)) Act, No. 10 of 2003; to provide for the repeal of the Inland Revenue ((Special Provisions)) Act, No. 10 of 2003; and for matters connected therewith or incidental thereto".*

[20] The Inland Revenue (Regulation of Amnesty) Act, No. 10 of 2004 clearly repealed the Inland Revenue (Special Provisions) Act, No. 10 of 2003. Section 4(4) of the Inland Revenue (Regulation of Amnesty) Act, No. 10 of 2004 provides as follows:

> "*(4) Any proceedings, investigation or inquiry which was being conducted by the Commissioner-General or any Authority administering the collection and recovery of any tax, levy or penalty, (including any penalty in respect of any offence) forfeiture or fine in terms of any law referred to in the Schedule of the Inland Revenue (Special Provisions) Act, No. 10 of 2003, and which has been, stopped, suspended or withdrawn in terms of the aforesaid Act, shall from the date of the coming into operation of this Act, be revived or restored and continued with, as if such proceedings, investigation or inquiry had not been so stopped, suspended or withdrawn".*

[21] The Appellant argued that the proceedings that were discontinued by the BOR could not have been considered as proceedings pending before the Commissioner General or any authority administering the collection and recovery of any tax and accordingly, the proceedings which could be revived or restored and continued with, would not apply to proceedings which were discontinued by the BOR. The same question was raised before the BOR and the BOR referred to the Supreme Court determination in respect of the Inland Revenue (Regulation of Amnesty) Bill (SC-SD No. 26/2004-SC Minutes dated 23.08.2004 (Vide- p.p.2-3 of the BOR determination) and the BOR rejected the said objection.

[22] It is obvious that by virtue of the Inland Revenue (Special Provisions) Act, No. 10 of 2003, the proceedings before the BOR were discontinued and the Appellant was benefiting from that law. The Inland Revenue (Regulation of Amnesty) Act, No. 10 of 2004 was enacted *inter alia*, to repeal the said Act and to revive or restore or continue with the proceedings, investigation or inquiry which were stopped, suspended or withdrawn. The provisions of section 4(4) of the Inland Revenue (Regulation of Amnesty) Act, No. 10 of 2004 does not indicate that the intention of the legislature was to revive or restore or continue with proceedings or investigation or inquiry which were being conducted only by the Commissioner General or any other authority empowered to recover taxes, but exclude proceedings which were discontinued on the basis of section 4(3) of the Inland Revenue (Special Provisions) Act, No. 10 of 2003. In my view, the Inland Revenue (Regulation of Amnesty) Act, No. 10 of 2004 revived or restored the proceedings which were discontinued before the BOR on the basis of section 4(3) of the Inland Revenue (Special Provisions) Act, No. 10 of 2003, and therefore, the assessments under appeal were not final and conclusive in terms of section 4(3) of the Inland Revenue (Special Provisions) Act, No. 10 of 2003.

[23] Though the Appellant has not made an application seeking an amnesty under the Inland Revenue (Special Provisions) Act, No. 10 of 2003 and an appeal had been made against the assessments, the Commissioner General or any authority charged with the administration of the laws specified in the schedule thereto, are obliged to comply with the provisions of the said Act. Accordingly, the Appellant who was benefiting from the provisions of the Act, No. 10 of 2003 cannot be heard to say that the Inland Revenue (Regulation of Amnesty) Act, No. 10 of 2004 did not apply to the Appellant and any proceeding which has been, stopped, suspended or withdrawn in terms of the Inland Revenue (Special Provisions) Act, No. 10 of 2003, cannot be revived or restored and continued with, in terms of the provisions of the Inland Revenue (Regulation of Amnesty) Act, No. 10 of 2004.

[24] The Appellant further contended that the Inland Revenue (Regulation of Amnesty) Act, No. 10 of 2004 cannot apply to the Appellant as the Appellant did not make any application seeking amnesty under the Inland Revenue (Special Provisions) Act, No. 10 of 2003 in respect of non-payment or non-disclosure of liability by making a statutory declaration for the purpose. The Appellant relies on section 6(3) of the Interpretation Ordinance, No. 21 of 1901

(as amended) and argues that it was able to acquire a right within the contemplation of section 6(3) as the Appellant did not seek an amnesty by making a declaration under section 2 of the Inland revenue (Special provisions) Act, No. 10 of 2003. Section 6 (3) provides:

> *"Whenever any written law repeals either in whole or part a former written law, such repeal shall not, in the absence of any express provision to that effect, affect or be deemed to have affected-*
>
> *(a) The post operation of or anything duly done or suffered under the repealed written law;*
> *(b) Any offence committed, any right, liberty or penalty acquired or incurred under the repealed written law;*
> *(c) Any action, proceeding, or thing pending or incompleted when the repealing written law comes into operation, but every such action, proceeding, or thing may be carried on and completed as if there had been no such repeal".*

[25] Section 2 of the Inland Revenue (Special Provisions) Act, No. 10 of 2003 applies to any person who has made a declaration to the Commissioner General before June 30, 2003 and such persons may be entitled to immunity from liability to pay tax or from any investigation or prosecution for any offence under any law specified in the Schedule hereto (Vide- section 2 and 3). On the other hand, the same Act also applies to any person who has not made a declaration in terms of section 2, but there is any tax in dispute under any of the laws specified in the Schedule hereto, pertaining to tax, in respect of any period ending on or before March 31, 2000 (Vide- section 4 (3). Then, the tax specified by such person, as being the amount of tax payable by him shall be accepted by the relevant authority, charged with the administration of the laws specified in the Schedule hereto, as being correct and reflecting the final tax liability of that person in respect of such period (supra).

[26] The Supreme Court in its determination in respect of the Inland Revenue (Regulation of Amnesty) Bill (SC-SD No. 26/2004-SC) considered the effect of the Act No. 10 of 2004 on section 6(3) of the Interpretation ordinance and held that the effect was to completely negate the vested right acquired by a taxpayer. The Supreme Court considered the effect of section 6(3) of the Interpretation ordinance and stated as follows:

"The effect of section 6(3) is that in the absence of any express provision, the repeal by itself does not affect the past operation or any right acquired under the law that is being repealed. However,, by an express provision the past operation of the law that is being repealed could be denuded of any effect so that any right acquired thereunder would be of no force or avail. Additional Solicitor General submitted that what is sought to be done by the present amendment is to restore the status quo ante so that any liability operative prior to the grant of the amnesty or immunity under Act, No. 10 of 2003 is fully revived.

We are of the opinion that in terms of Article 75 of the Constitution read with section 6 (3) of the Interpretation ordinance, it is within the legislative competence of parliament to make provision for the revival of any liability, duty or obligation that was operative under the relevant laws, and thereby remove the legal effect of any concession, indemnity or immunity granted under Act, No. 10 of 2003, as amended, provided that the revival of such liability, duty or obligation would in itself not be inconsistent with the Constitution".

[27] The Appellant further argued that section 4(4) of the Inland Revenue (Regulation of Amnesty) Act, No. 10 of 2004 does not contemplate a retrospective restoration of the status quo in respect of hearings before the BOR, the Court of Appeal or the Supreme Court. The Appellant further argued that the reference to the Commissioner-General in section 4(4) must be read subject to the statutory definition of the phrase as contemplated in section 8 of the said Act read with section 186 of the Inland Revenue Act, No. 38 of 2000 and the said reference does not encompass hearings before the BOR.

[28] In my view section 4(4) provides an answer to this contention of the Appellant. Section 4(4) clearly provides that "any proceedings, investigation or inquiry" which was being conducted by the Commissioner General or any authority administering the collection and recovery of any tax, levy or penalty or forfeiture or find in terms of any law …. …which has been stopped, suspended or withdrawn in terms of the Inland Revenue (Special Provisions) Act, No. 10 of 2003, **shall from the date of the coming into operation of this Act, be revived or restored and continued with**, **as if such proceedings, investigation or inquiry had not been so stopped, suspended or withdrawn.** It is crystal clear that the Inland Revenue (Regulation of Amnesty) Act, No. 10 of 2004 applies to such proceedings, investigation or inquiry retrospectively, and if the Appellant's argument is valid, the purpose of the Inland Revenue (Regulation of Amnesty) Act, No. 10 of 2004 is meaningless.

[29] The learned Deputy Solicitor General drew our attention to the decision of this Court in *Mohideen v. Commissioner General of Inland Revenue* (2015) XXI The BALR 171, which considered the revival of the proceedings before the BOR consequent upon the enactment of the Inland Revenue (Regulation of Amnesty) Act, No. 10 of 2004. In that case also, the Appellant's main contention was that when the Inland Revenue (Special provisions) Act, No. 10 of 2003 was repealed by the Inland Revenue (Regulation of Amnesty) Act, No. 10 of 2004, it did not retrospectively extinguish vested rights. The Court of Appeal considered the following identical question in that case:

> *"Has the Board of Review erred in law by coming to the conclusion that it was not prevented from reopening this case since section 4(3) of the Inland Revenue (Special Provisions) Act, No. 10 of 2003 (read with section 4(4) of the Inland revenue (regulation of Amnesty) Act, No. 10 of 2004 and section 6(3) of the Interpretation ordinance, No. 21 of 1990 (as amended) makes it clear that amount specified by the Appellant must be treated as his final tax liability?"*

[30] To answer this question, the Court of Appeal proceeded to ascertain whether the benefit accrued to the Appellant by section 2(2) of the Act No. 10 of 2003 would continue to remain in terms of section 6(3) of the Interpretation Ordinance, and held at p. 174 that:

> *" The effect of the above provision was to repeal the Act, No. 10 of 2003, subject to certain express reservations, and thereby remove the legal effect of any concession, indemnity or immunity that was granted and to provide for the revival of all liabilities, duties and obligations that existed prior to the Act, No. 10 of 2003.*

[31] The Court of Appeal further relied on the following passage from the S.C determination and held that the effect of the Act, No. 10 of 2004 goes beyond a repeal of Act No. 10 of 2003 and has the effect of wiping out that law from the statute book altogether. The Court of Appeal relied on the following passage from the SC determination:

> *"Clause 2(2) of the Bill makes further provisions to the effect that "Act No. 10 of 2003, shall except in so far as the same is necessary for the implementation of the provisions of section 3 of this Act, be deemed to have never been in operation as if the same had not been enacted.".*

[32] Accordingly, the Court of Appeal held that the BOR was not prevented from re-opening the case of the Appellant and all liabilities, duties and obligations that existed prior to the Act, No. 10 of 2003 have to be revived. At page 175 , Gooneratne J. stated:

> *"I am inclined to agree with the submissions of State Counsel as regards the (i) question of law, thus the Board of Review was not prevented from re-opening the case of the Appellant. Therefore all liabilities, duties and obligations that existed prior to the Act, No. 10 of 2003 has to be revived, and the Appellant would be liable to pay taxes based on the assessable income determined by the Commissioner of Inland Revenue".*

[33] For those reasons, I am of the view, there is no merit in the contention of the Appellant that assessments under appeal had already been concluded to be final and conclusive in terms of section 4(3) of the Inland Revenue (Special provisions) Act, No. 10 of 2003 and section 6(3) of the Interpretation Ordinance, No. 2 of 1991 (as amended). Accordingly, the question of law No. (a) must be answered in favour of the Respondent.

Question of Law No. (b)

Where the proceedings before the Board of Review is time barred in terms of the proviso to section 140(10) of the Inland Revenue Act, No. 38 of 2000 as amended by the Inland Revenue (Amendment) Act, No. 37 of 2003?

[34] At the hearing, Dr. Shivaji Felix submitted that since the Respondent had referred the appeal to the BOR by communication dated 15.06.2001 after the enactment of the Inland Revenue Act, No. 38 of 2000, which came into effect on 03.08.2000, the time bar envisaged by the first proviso to section140(10) of the said Act would come into operation within two years from the date of commencement of the Inland Revenue Act, No. 38 of 2000, namely on 03.08.2002. He argued that as the statutory amendment to section 140(10) in relation to time bar is retrospective in operation and the reference to the "commencement of this Act" in the second proviso to section 140(10) is a reference to the principal enactment, namely, the Act, No. 38 of 2000. Dr. Shivaji Felix further argued that the second proviso to section 140(10) of the Inland Revenue Act (as amended) also applies to pending appeals and also to assessments made under the provisions of the Inland Revenue Act, No. 28 of 1979 and other prior enactments which were under appeal and awaiting adjudication. He submitted that the term "hearing" in section 140(1) does not

refer to "oral hearing" and the word "hearing" refers to "to hear and determine" (Stroud's Judicial Dictionary (London Sweet & Maxwell, 5thedn., 51, LJQB 44).

[35] He submitted that the determination was made on 28.10.2009 and therefore, the appeals should have been determined after the period of 2 years from the date of commencement of the Inland Revenue Act, No. 38 of 2000. He further submitted that the time bar envisaged by the first proviso to section 140(10) would have come into effect on 02.08.2002 and in the instant case, even if it is assumed that the operative date for the determination of the statutory time bar was 01.04.2003, the statutory time bar would have come into effect on 01.04.2005. He submitted that the Court of Appeal in *Mohideen v. Commissioner -General of Inland Revenue* (CA 2/2007 (20-15) Vol. XXI. BASL Law Journal, page 171 decided on 16.01.2014, erred in holding that the hearing contemplated by section 140(10)) of the Inland Revenue Act, No. 38 of 2000 as amended by section 52 of the Amended Act No. 37 of 2003 was an oral hearing and not to the date of submission to the jurisdiction of the BOR.

[36] Section 140 of the Inland Revenue Act, No. 38 of 2000 was amended by section 52 of the Inland Revenue (Amendment) Act, No. 37 of 2003 which came into effect on 01.04.2003 (see- section 59 of the Inland Revenue (Amendment) Act, No. 37 of 2003). Section 140(10) of the Inland Revenue Act, No. 38 of 2000 as amended by the Inland Revenue (Amendment) Act, No. 37 of 2003 provides:

> *"(10) After hearing the appeal, the Board shall confirm, reduce, increase or annul the assessment as determined by the Commissioner-General on appeal, or as referred by him under section 139, as the case may be, or may remit the case to the Commissioner-General with the opinion of the Board. thereon. Where a case is so remitted by the board, the Commissioner-General shall revise the assessment as the opinion of the Board may require. The decision of the Board shall be notified to the appellant and the Commissioner- General in writing.*
>
> *Provided however, the Board shall make its determination or express its opinion as the case may be, within two years from the date of commencement of the hearing of such appeal:*
>
> *Provided further where the hearing of any appeal has commenced at the date of commencement of this Act, the appeal shall be determined or an opinion shall be expressed within two years from the commencement of this Act".*

[37] Now the question is whether or not the BOR had made its determination within a period of 2 years from the date of the commencement of the hearing of such appeals. The appeal for the period 1994/1995 was made on **25.05.1998** and the appeal for the period 1995/1996 was made on **23.03.1999**. The appeals were referred to the BOR by the Respondent on 08.06.2001 and the determination was made by the BOR on **28.10.2009**. As the first proviso to section 140(10) of the Inland Revenue Act, No. 38 of 2000 as amended by the Inland Revenue (Amendment) Act, No. 37 of 2003 came into effect on 01.04.2003 after the appeals were referred to BOR but before the determination was made, the BOR should have made the determination within two years from the date of commencement of the hearing of such appeal. The question is as to when the hearing commenced.

[38] The Court of Appeal in *Mohideen v. Commissioner -General of Inland Revenue* (supra) considered the question of the actual date of hearing intended by Parliament in the second proviso to Section 140 (10) of the Inland Revenue (Amendment) Act, No. 37 of 2003, for the purpose of the time limit of the appeal. The Court of Appeal held that the hearing means the "date of the actual oral hearing" and the BOR made its determination within 2 years from the date of the oral hearing, and thus, it is not time barred. His Lordship Gooneratne J. having considered the question involved (Question No. 2 in that case), held with the Respondent on the basis that the hearing for the calculation of the time limit of 2 years specified in section 140 (10) commences 'from the date of the oral hearing' and 'not from the date of filing of the petition of appeal'. I have no reason to deviate from the view taken by Gooneratne, J. in *Mohideen v. Commissioner-General of Inland Revenue* (supra). I hold that when the legislation provides that when the BOR shall hear all appeals received by it and make its determination, "within two years from the date of commencement of the hearing of such appeal", the hearing commences from the date of oral hearing. In the present case, the oral hearing commenced on 08.06.2008 and the determination was made on 28.10.2009.

[39] On the other hand, this Court has consistently taken the view that the word "shall" used in section 10 of the TAX Appeals Commission Act, No. 10 of 23 of 2001 is normally to be interpreted as connoting a directory, and not a mandatory provision. In *Stafford Motor Company Limited v. The Commissioner General of Inland Revenue (CA Tax* CA /Tax/17/2017, decided on 15.03.2019), Janak de Silva, J.held that the Tax Appeals Commission Act, No. 23 of 2011 (as

amended) does not spell out any sanction for the failure on the part of the Tax Appeals Commission to comply with the time limit set out in section 10 of the Tax Appeals Commission Act.

[40] We took the same view in our judgments in *Mr. S.P. Muttiah v. The Commissioner General of Inland Revenue,* CA/TAX/46/2019, decided on 26.06.2021 and *Amadeus Lanka (Pvt) Ltd v. CGIR* (C.A Tax 4/19 decided on 30.07.2021 and *Unilever Sri Lanka Limited v CGIR* (CA Tax CA/TAX/0018/2014 04.11. 2022). In *Mr. S.P. Muttiah v. The Commissioner General of Inland Revenue* (supra), we further held that the directory interpretation of Section 10 is consistent with the object, purpose and design of the Tax Appeals Commission Act, which is reflected in the intention of the legislature. We held that if a gap is disclosed in the Legislature, the remedy lies is an amending the Act and not in a usurpation of the legislative function under the thin disguise of interpretation.

[41] In *S.P. Muttiah v. Commissioner General of Inland Revenue* (supra), this Court held at page 77 and 78:

> *"If we interpret the legislative intent of Section 10 from its mere phraseology, without considering the nature, purpose, the design, the absence of consequences of non-compliance and practical impossibility, which would follow from construing it one way or the other, it will tend to defeat the overall object, design, the purpose and spirit of the Tax Appeals Commission Act".*

[42] We hold that if the Respondent had complied with the provisions of section 117(12) of the Inland Revenue Act, No. 28 of 1979, and subject to our determination on the question of law No. "C", in respect of the assessment 1994/1995, the determination of the BOR has been made within a period of 2 years from the date of the oral hearing which commenced on 08.06.2008.

Question of Law No. "C"

Is the determination of the Commissioner General of Inland Revenue time barred in respect of the year of assessment 1994/1995 in terms of section 117(12) of the Inland Revenue Act, No. 28 of 1979 and if so, whether the BOR was prevented from hearing the appeal in respect of the said year of assessment 1994/1995?

[43] This question of law No. "C" applies only to the year of assessment 1994/1995. The contention of Dr. Shivaji Felix was that the BOR is prevented

from hearing the appeal in respect of the year of assessment **1994/1995** since it has already been determined by operation of law in terms of the imperative provisions of section 117(12) of the Inland Revenue Act, No. 28 of 1979. The Respondent's position is, however, that the valid acknowledgement of the appeal is the letter titled "acknowledgement of the Appeal" signed by the Senior assessor, the date of which appears to be **24.06.1998** and issued under section 117(12) of the Inland Revenue Act.

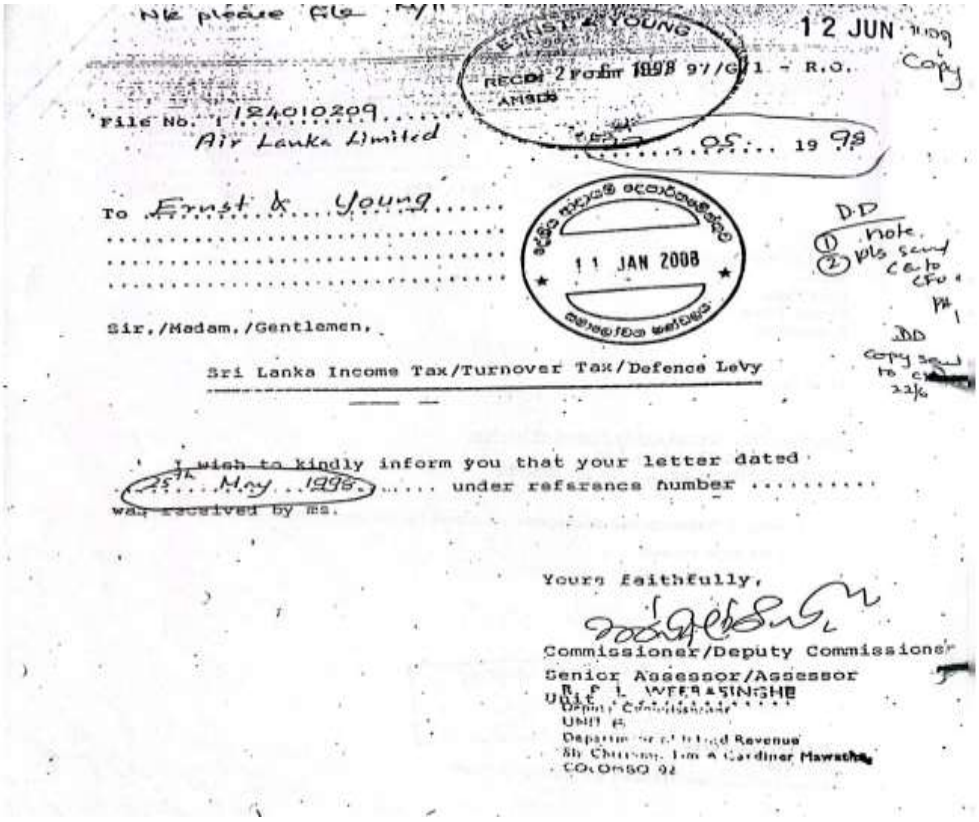
[44] The question that arises for determination is as to which document is the valid acknowledgement of the appeal in terms of section 117(12) of the Inland Revenue Act, No. 28 of 1979, namely, whether it is the letter issued by the Deputy Commissioner of Inland Revenue dated **27.05.1998** or the letter issued by the Senior Assessor dated **02.06.1998** or the date of which appears to be **24.06.1998**. Section 117(12) of the Inland Revenue Act, No. 28 of 1979 as amended by the Inland Revenue (Amendment) Act, No. 8 of 1987 and the Inland Revenue (Amendment) Act, No. 11 of 1989 provides as follows:

> *"(12) Every petition of appeal preferred, under this section, on or after April 1, 1987, shall be agreed to, or determined,* ***within three years from the date on which such petition of appeal is received by the Commissioner General,*** *unless the agreement or determination of such appeal depends on the furnishing of any document or the taking of any action, by any person other than the appellant or the Commissioner-General or an assessor.*
>
> *Where such appeal is not agreed to or determined within such period, the appeal shall be deemed to have been allowed and tax charged accordingly.* ***The receipt of every appeal received under this section shall be acknowledged and the date of the letter of acknowledgement shall for the purposes of this section be deemed to be the date of Receipt of such appeal".***

[45] It is not in dispute that the appeal to the Commissioner General in respect of the year of assessment **1994/1995** was made by the Appellant on **25.05.1998** and the Commissioner General by letter dated **15.06.2001,** informed the Appellant that the appeal had been referred to the BOI in terms of section 120 of the Inland Revenue Act, No. 28 of 1979. The BOR in its determination however, states that the appeal was made to the BOR on **08.06.2001.** The Appellant's position is that the appeal was acknowledged by the Deputy Commissioner of Inland Revenue by letter dated **27.05.1998** and the Deputy Commissioner is statutorily empowered to perform functions

assigned by law to the Commissioner-General of Inland Revenue if there is a general authorization for the purpose of by the Commissioner-General of Inland Revenue.

[46] The definition of the "Commissioner-General" in section 163 of the Inland Revenue Act, No. 28 of 1979 includes in relation to any provision of the Act, a Senior Commissioner and a Deputy Commissioner who is specifically authorized by the Commissioner-General either generally or for some specific purpose to act on behalf of the Commissioner-General. It is not in dispute that the Deputy Commissioner is entitled to perform an administrative function conferred by section 117(12) of the Act and sign the acknowledgement letter, acting under the delegated powers or on the basis of implied authority on behalf of the Commissioner-General. The letter dated 27.05.1998 issued by the Deputy Commissioner was addressed to the Tax Consultant of the Appellant, **Ernst & Young, and it merely states £your letter dated 25.05.1998 was received by me".** It reads as follows:


We please file
ERNST & YOUNG
12 JUN
Copy
RECD 2 Form 1998 97/G/1 - R.O.
File No. 1240102209
Air Lanka Limited
05 19 98
To Ernst & Young
11 JAN 2008
D.D
1 note.
2 pls send C/c to CFO.
Sir,/Madam,/Gentlemen,
Sri Lanka Income Tax/Turnover Tax/Defence Levy
I wish to kindly inform you that your letter dated
25th May 1998 under refsrance number
was received by me.
Yours faithfully,
Commissioner/Deputy Commissioner
Senior Assessor/Assessor
R. P. L. WEERASINGHE
Unit
Unit 6
Department of Inland Revenue
5th Floor, Lm A Gardiner Mawatha
COLOMBO 02

[47] The learned Deputy Solicitor General tagged this letter as "over the counter chit" given as proof of the taking physical custody of any the petition of appeal by the Inland Revenue Department. He submitted, however, that a valid acknowledgement of appeal goes beyond the mere acceptance of a petition of

appeal as required by law. In my view the mere acceptance of a petition of appeal is only proof of the taking of its physical custody, which does not make a valid acknowledgement of an appeal unless the relevant provisions of section 117 of the Inland Revenue Act are fulfilled. An acknowledgement of appeal means an acceptance of valid appeal which conforms to the provisions of subsections (2), (3) and (3A) of section 117 of the Inland Revenue Act, No. 28 of 1979. Where any appeal has been filed in violation of such provisions shall not be valid, and such appeal cannot be acknowledged as a valid appeal. The relevant provisions of section 117 of the Inland Revenue Act, No. 28 of 1979 (as amended) provide:

> *"117 (1) Any person who is aggrieved by the amount of an assessment made under this Act or by the amount of any valuation for the purpose of this Act may, within a period of thirty days after the date of the notice of assessment appeal to the Commissioner-General against such assessment or valuation.*
>
> *Provided that the Commissioner General upon being satisfied that owing to absence from Sri Lanka, sickness or other reasonable cause, the appellant was prevented from appealing within such period, shall grant an extension of time for preferring the appeal.*
>
> *(2) Every appeal shall be preferred by a petition in writing addressed to the Commissioner-General and shall state precisely the grounds of such appeal.*
>
> *(3) Where the assessment appealed against has been made in the absence of a return, the petition of appeal shall be sent together with a return duly made.*
>
> *(3A) Every person preferring an appeal under subsection (1) against the amount of an assessment for any year of assessment commencing on or after April 1, 1991, shall unless such person has done so already, pay to the Commssioner-General the amount of the tax payable by such person on the basis of the return furnished by him for that year of assessment together with any penalty thereon accrued up to the date of such notice of assessment and shall attach to the petition of appeal,a receipt in proof of such payment.*
>
> .....
>
> *(4) Every petition of appeal which does not conform to the provisions of subsections (2) and (3) shall not be valid.*

(5) On receipt of a valid petition of appeal, the Commissioner-General may cause a further inquiry to be made by an Assessor, and if in the course of such inquiry an agreement is reached as to the matters specified in the petition of appeal, the necessary adjustment of the assessment shall be made.

(6) Where no agreement is reached between the appellant and the Assessor in the manner provided in subsection (5), the Commissioner-General shall, subject to the provisions of section 120, fix a time and place for the hearing of the appeal.

(7) Every appellant shall attend before the Commissioner-General at the time and place fixed for the hearing of the appeal. The appellant may attend the hearing of the appeal in person or by an authorized representative. The Commissioner-General may, if he thinks fit, from time to time adjourn the hearing of an appeal for such time and place as he may fix for the purpose. In any case in which an authorized representative attends on behalf of the appellant, the Commissioner-General may adjourn the hearing of the appeal and may, If he considers that the personal attendance of the appellant is necessary for the determination of the appeal, require that the appellant shall attend in person at the time and place fixed for the adjourned hearing of the appeal. If the appellant or his authorized representative fails to attend at the time and place fixed for the hearing or any adjourned hearing of the appeal, or if the appellant fails to attend in person when required so to attend by the Commissioner-General, the Commissioner-General may dismiss the appeal:……"

[48] If the appeal has been filed out of time or in contravention of the provisions of subsection 2, 3 and 3A cannot be regarded as a valid acknowledgement of appeal under section 117(12) of the Act and such appeal cannot be subject to an a further inquiry and subsequent hearing in terms of the provisions of subsection (5) or (7) of section 117 of the Act. If the Appellant has not complied with section 3A of the Act, in particular, such an appeal may not be acknowledged as a valid appeal and that matter must be decided subsequent to the receipt of the petition of appeal by the Respondent. I am of the view that the mere issuing of a letter dated 27.05.1998 addressed to the Tax Consultant, taking of physical custody of a petition of appeal, making a minute "Please send CE to CFO" and stating "**your letter dated 25.05.1998 was accepted**" cannot be regarded as a valid acknowledgement of appeal unless the Commissioner General is satisfied with the provisions of subsections 2, 3 and 3A of the Act.

[49] I will now turn the letter dated **02.06.1998** issued by the assessor Unit 1. The Respondent relies on the carbon copy of the letter marked "R1" signed by the assessor Unit 1 as the valid letter of acknowledgement of the appeal and contend that the date of the acknowledgement is **24.06.1998.** Paragraph 1 states as follows:

> ***"I hereby acknowledge receipt of your appeal made by letter of 27.05.98 against the assessment issued for the above year of assessment"***

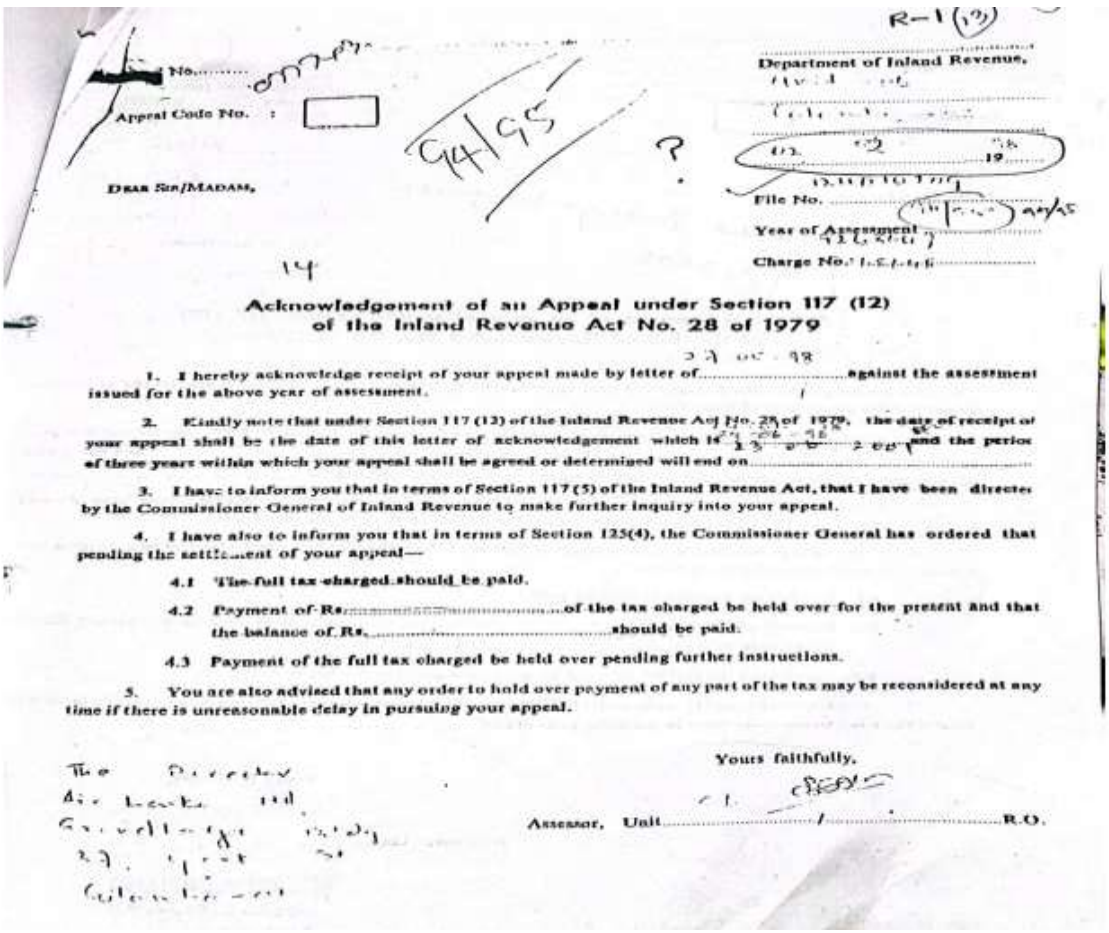
[50] Paragraph 2 of the said letter states:

> *Kindly note that under section 117(12) of the Inland Revenue Act, No. 28 of 1979,* ***the date of receipt of your appeal shall be the date of his letter of acknowledgement which is 24.06.98*** *and the period of three years within which your appeal shall be agreed or determined will end on 23.06.2001".*

[51] The month on the top of the said letter appears to have been rewritten by deleting the month from "02" to "06" which, however, indicates clearly that the date of the said letter of acknowledgement is **02.06.1998 and not 24.06.1998** as claimed by the Respondent. The letter of acknowledgement relied on by the Respondent is clearly **02.06.1998,** and thus, the said date of acknowledgement (**02.06.1998**) shall for the purpose of section 117(12) be deemed to be the date of receipt of the appeal.

[52] The Respondent having acknowledged the receipt of the appeal dated 27.05.1998 by letter of acknowledgement dated **02.06.1998 that** states in the same letter dated 02.06.1998, that t**he date of receipt of the appeal shall be this letter of acknowledgement, which is 24.06.1998** and the period of three years within which your appeal shall be agreed or determined will end on 23.06.2001. In my view the Commissioner General shall determine the date of acknowledgement on the basis of the provisions of section 117(12) of the Inland Revenue Act. He cannot determine the date of acknowledgement as and when he pleased, and determine any future date for his own convenience as the date of acknowledgement as it has happened in the instant case. Section 117(12) clearly provides that the date of the **letter of acknowledgement** shall be deemed to be the date of **receipt of such appeal**. It is relevant to note that the Senior Assessor, Chitralatha in her letter dated **26.05.2008** admits that the **"The**

appeal has been legally acknowledged on 02.06.1998. For some unknown reason, she further states, referring to an entry made by the assessor in the letter dated 02.06.1998 marked R1 that the date of acknowledgement is **24.06.1998**. This contradicts her own statement that **"The appeal has been acknowledged on 02.06.1998".** The said letter is reproduced for clarity as follows:



R-1 (13)

Department of Inland Revenue,

No.

Appeal Code No. :

DEAR SIR/MADAM,

File No.

Year of Assessment

Charge No.

Acknowledgement of an Appeal under Section 117 (12) of the Inland Revenue Act No. 28 of 1979

1. I hereby acknowledge receipt of your appeal made by letter of against the assessment issued for the above year of assessment.

2. Kindly note that under Section 117 (12) of the Inland Revenue Act No. 28 of 1979, the date of receipt of your appeal shall be the date of this letter of acknowledgement which is and the period of three years within which your appeal shall be agreed or determined will end on

3. I have to inform you that in terms of Section 117 (5) of the Inland Revenue Act, that I have been directed by the Commissioner General of Inland Revenue to make further inquiry into your appeal.

4. I have also to inform you that in terms of Section 125(4), the Commissioner General has ordered that pending the settlement of your appeal—

4.1 The full tax charged should be paid.

4.2 Payment of Rs. of the tax charged be held over for the present and that the balance of Rs. should be paid.

4.3 Payment of the full tax charged be held over pending further instructions.

5. You are also advised that any order to hold over payment of any part of the tax may be reconsidered at any time if there is unreasonable delay in pursuing your appeal.

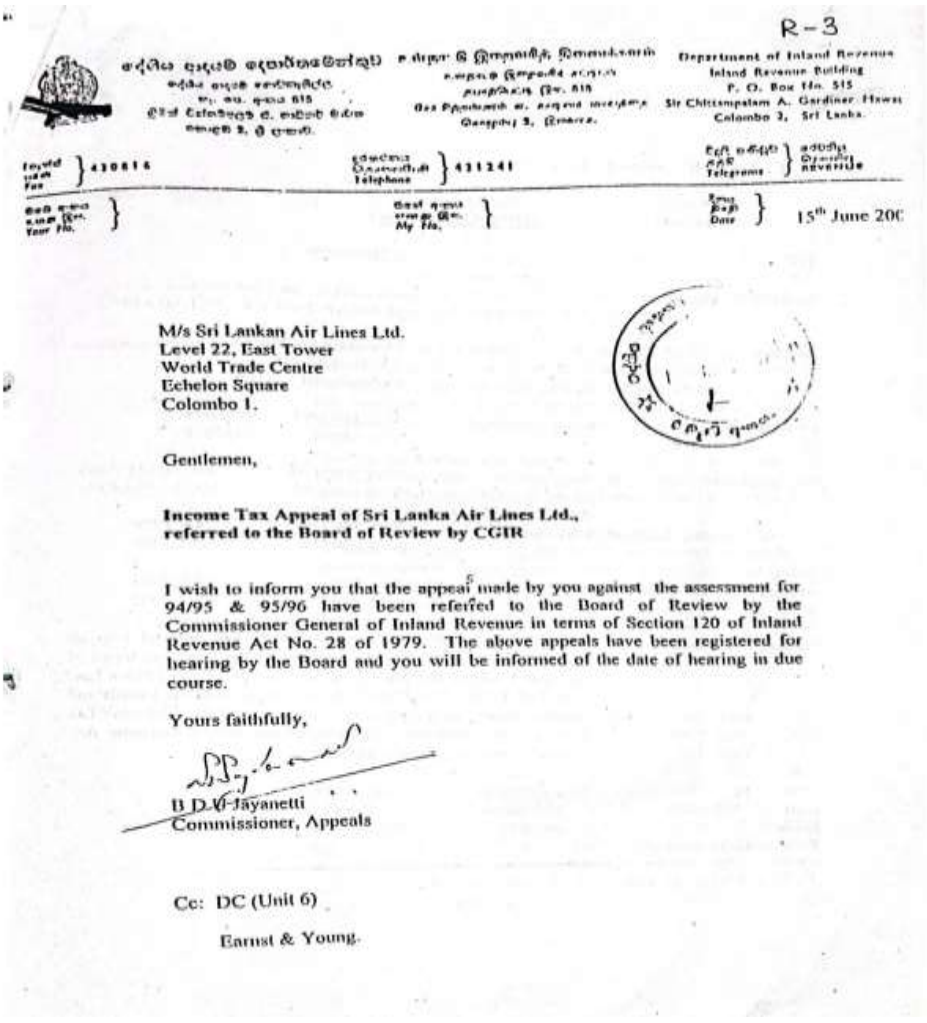
Yours faithfully,

Assessor, Unit R.O.

[53] Accordingly, it is absolutely clear that the date of the acknowledgement of the appeal was 02.06.1998 and thus, the appeal shall be determined by the Commissioner General within three years from the date on which such appeal was received by the Commissioner General, which is the date of the letter of acknowledgement, namely, **02.06.1998.** The BOR has erroneously taken the view that the "the date of the receipt of your appeal shall be the date of this letter of acknowledgement which is 24.06.1998 and the period of three years within which your appeal shall be agreed or determined will end on 23.06.2001", when the date of acknowledgement of the appeal is **02.06.1998**, which date shall be deemed to be the date of receipt of such appeal for the purposes of section 117(12).

[54] Accordingly, the appeal shall be determined by the Commissioner-General within a period of three years from the date of the receipt of such appeal, which according to section 117(12) was **01.06.2001** and not **24.06.2001** as set out in paragraph 2 of the said letter dated 02.06.1998. Where such determination is not made within such period, the appeal shall be deemed to have been allowed and tax discharged accordingly [(Vide-section 117(12)]. In the present case, however, the Commissioner General did not make a determination within a period of 3 years from the date of the acknowledgement of the appeal on 02.06.1998 and the period lapsed on 01.06.2001.

[55] The Commissioner-General, however, without making any determination of the appeals on or before **01.06.2001** referred the appeals directly to the BOR on **08.06.2001** under section 120 of the Inland Revenue Act (as amended and informed the Appellant accordingly. The said letter dated 15.06.2001 reads as follows:



R-3

Department of Inland Revenue
Inland Revenue Building
P. O. Box No. 515
Sir Chittampalam A. Gardiner Mawatha
Colombo 2, Sri Lanka.

Telephone 431241

15th June 200

M/s Sri Lankan Air Lines Ltd.
Level 22, East Tower
World Trade Centre
Echelon Square
Colombo 1.

Gentlemen,

Income Tax Appeal of Sri Lanka Air Lines Ltd., referred to the Board of Review by CGIR

I wish to inform you that the appeal made by you against the assessment for 94/95 & 95/96 have been referred to the Board of Review by the Commissioner General of Inland Revenue in terms of Section 120 of Inland Revenue Act No. 28 of 1979. The above appeals have been registered for hearing by the Board and you will be informed of the date of hearing in due course.

Yours faithfully,

B D U Jayanetti
Commissioner, Appeals

Cc: DC (Unit 6)
Earnst & Young

[56] Section 120 of the Inland Revenue Act provides:

> ***120***. *Notwithstanding the provisions of section 117, the Commissioner-General may refer any valid appeal made to him to the Board of Review, and the Board shall hear and determine such appeal, and accordingly, the provisions of section 121 shall apply to the hearing and determination of any appeal so referred.*

[57] The Respondent argued that the Commissioner-General was entitled to refer any valid appeal to the BOR under section 120 **at any time** disregarding the provisions of section 117 and therefore, the BOR was not prevented from making its determination in terms of the provision of section 140 of the Act. Now the question is whether the Commissioner General was prevented from referring the appeal for the year 1994/1995 to the BOR when he failed to make the determination of the appeal for the year 1994/1995 on or before 01.06.2001 in terms of section 117(12) of the Inland Revenue Act.

[58] The Respondent argues that as no time period is specified in section 120 of the Act to refer the appeal to the BOR, and the expression 'notwithstanding' implies that other provisions shall not prevail over section 120, it was justified in referring the appeal to the BOR on **08.06.2001** disregarding the provisions of section 117(12) completely. The learned Deputy Solicitor General argued before us that no time bar for making of the reference to the BOR has been set out in the Inland Revenue Act and, therefore, it is not possible for the court to introduce conditions to the exercise of the statutory power which the statute itself does not stipulate.

[59] The learned Deputy Solicitor General however, could not provide any reason as to why the Commissioner-General could not have referred the appeal to the BOR within the period of three years stipulated in section 117(12). He however, referred to the introduction of the Inland Revenue (Special Provisions) Act, No. 10 of 2003 by which a tax amnesty was granted to the taxpayer and the subsequent Inland Revenue (Regulation of Amnesty) Act, No. 10 of 2004 which made such amnesty invalid. It is relevant to note that both Acts were enacted after the period stipulated in section 117(12) was over and therefore, the Respondent could not have relied on the effect of the said two Acts for the delay in making the determination within the period stipulated in section 117(12) or referring the matter to the BOR without making the determination, if it thought that the proper forum, having regard to the nature of the appeal is the BOR. No explanation was offered on behalf of the Respondent for such delay in doing both acts.

[60] If the Respondent's argument is valid, the Commissioner-General can disregard the provisions of section 117(12) altogether by (i) refraining from acknowledging the appeal within the period stipulated therein and (ii) making the determination whatsoever, and keeping the appeal undetermined till the three year period stipulated in section 117(12) is over. If this argument is valid, the Commissioner General can refer any appeal to the BOR **at any time** irrespective of whether the period stipulated therein had lapsed many years ago. Is it the intention of the legislature in introducing the provisions of section 120? I do not think that the legislature ever intended to confer such an arbitrary power to the Commissioner-General is disregarding the whole provisions of section 117(12) completely and refer any appeal to the BOR long time after the period stipulated in section 117(12) has lapsed. It is neither fair nor desirable to expect the Legislature to intervene and include in any provision of law everything that should reflect the intention of the legislature and it is up to the Court to take stock to determine the nature of the provision, the context, object and purpose of scheme of the Act and interpret such provision which reflects the overall intention of the legislature. In the result, the provisions of section 120 must be read together with section 117(12) to gather the intention from the language employed, its context, and give effect to the intention of the legislature. It is relevant to the following statement expressed by P.M. Bakshi's Interpretation of Statutes, 2008 p. 517:

> *"It is well established that in interpreting a section of a taxing Act, which deals merely with the machinery of assessment and does not impose a charge on the subject, that construction should be preferred, which makes the machinery workable* ut res valeat potius quam pereat.*It is also well established that a construction so unreasonable ought not to be preferred when another construction is open and that an interpretation to be placed on the words of the section must be one which harmonises with the context and promotes in the fullest manner the policy and object of the Legislature"*.

[61] It is not a sound principle of construction to brush aside words in section 117(12) of the Inland Revenue Act and hold that the legislature allowed the Commissioner General to completely disregard the provisions of section 117 (12) and refer any appeal which is deemed to have been allowed for the failure to determine the appeal within the period stipulated in section 117(12).

[62] In my view, the Commissioner-General has two options under section 120 of the Act. The first option is that he shall determine the appeal within three

years from the date on which such appeal is received and for the purposes of section 117(12). The second one is that he may refer the appeal, without making a determination, to the BOR. Where the Commissioner-General fails to determine the appeal within the period specified in section 117(12), the law provides that the appeal shall be deemed to have been allowed and tax discharged, he cannot refer such appeal to the BOR after the period stipulated to make the appeal lapsed, disregarding the legal consequences of not determining the appeal within three years stipulated in section 117(12). I am unable to accept the argument of the learned Deputy Solicitor General that the absence of any reference to the time period within which the appeal may be directly referred to the BOR allows the Commissioner-General to refer any appeal which is not determined by him within the period of three years stipulated in section 117(12) when such appeal is deemed to have been allowed by operation of law.

[63] In the instant case, the statutory period for the determination of the appeal ended on 01.06.2001 and the communication was made after the expiry of the statutory time period for the determination of the appeal as required by section 117(12) of the Inland revenue Act. For those reasons, I hold that the appeal for the year of assessment **1994/1995** shall be deemed to have been allowed and tax discharged for the failure of the Commissioner to determine the appeal within the period of three years stimulated in section 117(12). Accordingly, the Commissioner-General is prevented from referring such appeal to the BOR after the said period of three years stipulated in section 120 of the Act for the year of assessment 1994/1995 had lapsed. For those reasons, the question of law No. "C" is answered in favour of the Appellant in respect of the year of assessment **1994/1995**.

Question of Law, No. "d"

Is the interest income from short term deposits covered by the exemption granted in the BOI Agreement?

[64] The Appellant entered into the following Agreements with the GCEC/BOI under section 17(1) of the GCEC/BOI Law, No. 4 of 1978 (as amended):

Principal Agreement No. 972 dated 28.01.1982 (B);
Supplementary Agreement No. 25 (C);
Supplementary Agreement No. 32 (D);

Supplementary Agreement No. 184 (E).

[65] Clause 8 of the Agreement which relates to the tax exemption provides that the tax exemption is applicable to the "Enterprise in connection with and/or in relation to the said business". The Appellant claimed the exemption from the Inland Revenue Act under clause 8 of the Agreement No. 972 for the imposition and collection of income tax afforded by the said Agreement read with section 17 of the BOI Law.

[66] The Assessor however, disallowed the exemption on the basis that the said exemption from income tax has been granted to the Appellant under clause 8 of the Agreement for its business profits and income of the business which falls within section 3(a) of the Inland Revenue Act, No. 28 of 1979. The assessor decided that no exemption has been granted in respect of interest income which falls under section 3(e) of the Inland Revenue Act, and therefore, the Appellant is liable to income tax on the profits and income arising from the sources of interest and rent. Clause 8 of the Agreement, No. 972 reads as follows:

> *"(8) In accordance with and subject to the powers conferred on the commission under section 17 of the said Law, No. 4 of 1978 and any regulations that may be applicable thereto the* ***following benefits and/or exemptions*** *and/or privileges and* ***hereby granted to the Enterprise in connection with and/or in relation to the said business****:*
>
> *The Enterprise shall not be liable to any income tax, corporate tax or any tax or dividends or remittance of dividends, and royalties for a* ***period of seven years commencing from the date of commencement of commercial operation of the said business*** *as determined by the Commission (hereinafter referred to as "the said period"). After the expiry of the said period, the Inland revenue laws for the time being in force shall be applicable to the Enterprise".*

The word "Enterprise" is defined in the Agreement as follows:

> *"Enterprise shall mean AIR LANKA LIMITED"*

Whether the interest income earned by the Appellant is part of the business income covered by the tax exemption granted under the BOI Agreement?

[67] Dr. Shivaji Felix submitted that the income tax exemption conferred by the BOI has not been granted solely and exclusively for the "said business", but has been conferred for the activities that are connected with and/or related to the said business. He further submitted that interest earned by the Appellant has been derived from short term rupee overnight deposits which have been utilized for the working capital requirements of the Appellant, and interest earned is intrinsically linked with the business of the enterprise since deposits comprise part of the live working capital of the enterprise.

[68] He further submitted that the phrase "in connection with and/or in relation to the said business" refers to the fact that there must be a causal link with the activity in issue and the business of the enterprise which qualifies for tax exemption. He submitted that in the instant case, the interest earned is connected and inextricably linked with the "said business" inasmuch as the funds employed comprise part of the working capital of the business and, is therefore, within the income tax exemption conferred by the BOI. His contention is that tax exemption applies to both (i) profits and income" of the Enterprise, and (ii) income which is connected with or related to the business, and therefore, the interest earned on short term call deposits, which are used for the working capital of the company, constitutes part of the business income of the Appellant. He contended, therefore, that such interest which is connected with/ or related to the business qualifies for the BOI tax exemption.

[69] The substantive issue that arises for determination is whether the short term interest income earned from an interest bearing account, which is said to have been used for its working capital requirements falls under the exemption granted by the BOI Agreement. In deciding this issue, it is necessary to consider the following questions:

1. Whether the tax exemption granted by the BOI Agreement applies to the profits and income of the Enterprise referred to in the Agreement (business income); or

2. Whether it applies to the Enterprise generating interest income through short term call deposits and utilized for the working capital requirements which are connected with/ or related to the business referred to in the Agreement.

[70] A perusal of the Agreement No. 972 reveals that the tax exemption from the Inland Revenue Act applies to the Enterprise **in connection with or in relation to the said business for a period of seven years from the date of commencement of commercial operation of the said business** as determined by the BOI. The term "business" is defined in the recitals of the Principal Agreement (B) as follows:

> *"Whereas the Enterprise has applied for approval to set up/conduct and operate its business as a commercial airline providing international air transportation and all other ancillary and related services thereto including but not limited to Ground Handling Services referred to in the applications dated 5th May, 13th May and 21st May, 1980 (hereinafter collectively referred to as the said business).*

The business of the Enterprise thus, relates to:

1. Commercial airline providing international air transportation; and
2. All other ancillary and related services thereto (international air transportation) including but not limited to ground handling services referred to in the applications dated 5th, May, 13th May and 21st May, 1980.

[71] Accordingly, the tax exemption has been granted to the business of the Enterprise as a commercial airline operating and providing international air transportation and all other ancillary and related services thereto including but not limited to ground handling services. Dr. Felix strenuously argued that the interest income received by the Appellant through short term call deposits and utilized for the working capital requirements is connected with/ or related to the business of the Appellant, and therefore, the tax exemption applies to the Appellant in terms of the BOI Agreement. The learned Deputy Solicitor General however, argued that operating an interest bearing account and generating interest income through short term call deposits and utilized for the working capital requirements is neither a service provided by the Appellant nor connected with or related to the business of providing international air transportation and all other ancillary and related services concerning the international air transportation.

Is interest received by the Appellant a source of income under section 3(a) or section 3(e) of the Inland Revenue Act?

[72] Now the question is to consider whether the interest income can be categorized as "profits and income" earned by the Appellant from business falling within the ambit of section 3 (a) of the IRA 2006, and if not, whether the interest income can also fall within the ambit of section 3(e) of the Inland Revenue Act, No. 28 of 1979. Dr. Felix relied on several authorities to support his contention that the funds that were actively engaged as working capital constituted part of the live working capital, and as such constituted part of its business income. In *Liverpool and London and Global Insurance Co. v. Bennett* (1974) STC 342, at p. 366, where Lord Avonside stated:

> *"Income becomes a trading when it arises from capital activity employed and at risk in the business, capital which is employed in the business because it is required for its support or, perhaps, to attract customers looking to the credit of the business. Trading income is "the fruit" of the capital employed in the business in a present and active sense".*

[73] The seond case was *Nuclear Electric Plc v. Bradley* (1996) STC 405, at pp. 411-412, where Lord Jauncey on the question whether income from investments constitutes trading income, stated:

> *"Whether income from investments held by a business is trading income must ultimately depend upon the nature of the business and the purpose for which the fund is held. At one end of the scale are insurance companies and banks part of whose business is the making and holding of investment to meet current liabilities. It has been suggested that tour operators might fall into this category, but without a good deal more information I do not feel able to express an opinion on this matter. At the other end of the scale are businesses of which the making and holding of investments form no part. In between these two ends, there will no doubt fall other types of businesses whose position is not so clear. However, in this case it is absolutely clear that the business of NE [Nuclear Electric plc] was to produce and supply electricity. The making of investments was neither an integral nor any part of its business. Furthermore the investments which it did make were in no sense employed in the business of producing electricity during the year of assessment. It follows that wherever the line may be drawn the income from NE's investment cannot be treated as trading income".*

[74] Dr. Felix submitted that in the present case, the interest received by the Appellant is connected and inextricably linked with the business specified in the Agreement inasmuch as the funds employed comprise part of the working capital of the business, and is therefore, well within the income tax exemption conferred by the BOI. He further submitted that the assessor has taken the view

that business falls under section 3(a) and interest income falls under section 3(e) however, in either case, the tax exemption conferred by clause 8(1) of the Agreement (E) is wide enough to encompass profits or income earned from interst. He referred to the decision in *Ceylon Financial Investments Limited V. Commissioner of Income Tax* (1941) 1 CTC 234 in support of its position that the interest income received by the Appellant comprises business income and submitted that although section 3(a) does not specifically refer to interest, it can constitute a profit from business as observed by the judges in *Ceylon Financial Investments Limited V. Commissioner of Income Tax* (supra) (hereinafter referred to as the 'CFI judgment). He submitted that judges in the CFI case concluded that the interest income is a source under section 6(1)(a) of the Income Tax Ordinance 1932 (corresponding to section 3(a) of the IRA 2006), instead of section 6(1)(e) (correspond to section 3(e) of the IRA 2006).

[75] It is not in dispute that section 6(1)(a) of the Income Tax Ordinance 1932 is corresponding to section 3(a) of the Inland Revenue Act, No. 28 of 1979 and section 6(1)(e) of the Income Tax Ordinance 1932 is corresponding to section 3(e) of the Inland Revenue Act, No. 28 of 1979. Mr. Jayasinghe, however, disputed the submission of Dr. Felix that the source of profit or income could fall within two separate subsections in section 3, and that the judgment in CFI is no authority for the assertion of the Appellant that the source of profits or income could fall within two separate subsections of section 3.

[76] We have to first turn to section 2 and 3 of the Inland Revenue Act, No. 28 of 1979. In terms of section 2 of the Inland Revenue Act, income tax shall, be charged at the appropriate rates for every year of assessment commencing on or after April 1, 1979, in respect of the profits and income of every person for that year of assessment. It reads as follows:

> "2. *(1) Income tax shall, subject to the provisions of this Act, be charged at the appropriate rates specified in the First, Second and Third Schedules to this Act, for every year of assessment commencing on or after April 1, 1979 in respect of the profits and income of every person for that year of assessment–*
>
> > *(a) wherever arising, in the case of a person who is resident in Sri Lanka in that year of assessment; and*
> >
> > *(b) arising in or derived from Sri Lanka, in the case of every other person.*

(2) For the purposes of this Act, "profits and income arising in or derived from Sri Lanka" includes all profits and income derived from services rendered in Sri Lanka or from property in Sri Lanka, or from business transacted in Sri Lanka, whether directly or through an agent".

[77] Section 3 of the Inland Revenue Act specified different sources of income and profits which are chargeable with income tax. Section 3(a) of the IRA 2006 provides as follows:

"For the purpose of this Act, "profits and income" or "profits" or "income" means-

(a) the profits from any trade, business, profession, or vocation for however short a period carried on or exercised;

(b) the profits from any employment;

(c) the net annual value of any land and improvements thereon occupied by or on behalf of the owner, in so far as it is not so occupied for the purposes of a trade, business, profession or vocation;

(d) the net annual value of any land and improvements thereon used rent-free by the occupier, if such net annual value is not taken into account in ascertaining profits and income under paragraphs (a), (b) or (c) of this section, or where the rent paid for such land and improvements is less than the net annual value, the excess of such net annual value over the rent to be deemed in each case the income of the occupier;

(e) dividends, interest or discounts;

(f) charges or annuities;

(g) rents, royalties or premiums;

(h) capital gains;and

(i) income from any other source whatsoever, not including profits of a casual and non-recurring nature.

[78] For the purpose of the determination of this Question of Law, it is necessary, first, to decide whether the interest income received by the Appellant is a source of income under section 3(a) or 3(e) of the Inland Revenue Act, 1979. Section 3 of the Inland Revenue Act, 1979 specified different sources of income and profits which are chargeable with income tax. Section 3(a) of the IRA 2006 provides as follows:

"For the purpose of this Act, "profits and income" or "profits" or "income" means-

(a) the profits from any trade, business, profession, or vocation for however short a period carried on or exercised".

[79] On the other hand, section 3(e) of the Inland Revenue Act, 1979 refers to income received from dividends, interest or discounts. It provides:

(e) "dividends, interest or discounts".

[80] It may be noted that the classification of the source of income is significant as different rates apply to different sources of income specified in the five Schedules to the Act. In the circumstance, it is necessary for the assessor to ascertain and identify the source of income for the purposes of determining the profits and income chargeable with income tax, and the rates applicable to such source of income.The list of heads in section 3 is the list of sources is one source such as "profits from one business" in section 3(a) is distinct from "dividends, interest or discounts" as a source.One of the heads (sources) is the "profits from any trade, business, profession or vocation for however short a period carried on or exercised" under section 3(a), and the other is "dividends, interest or discounts" under section 3(e) of the Act.

Judgment of the Supreme Court in Ceylon Financial Investments Limited V. Commissioner of Income Tax (CFI Case)

[81] I will now turn to the CFI judgment. The facts of the CFI judgment reveal that the assessee company was an **investment company** and its object was to invest money in shares in other companies. Its income was derived from dividends declared by companies in which it owned shares, and interest on moneys lent out by it. The company did not carry on any trade and claimed deductions from outgoings and expenses in the production of the profits or income within the meaning of section 9(1) of the Income Tax Ordinance (Chapter 188) (corresponding to section 25(1) of the IRA 2006).

[82] In the said case, the assessee argued that the interest income should be treated as a source under section 6(1)(a) of the Income Tax Ordinance 1932 (corresponding to section 3(a) of the IRA 2006), and the assessor in disallowing the management expenses claimed drew a distinction between an investment company and a company which carried on a trade or commercial enterprise. The assessor stated, however, that (i) an investment company does not incur any expense in the production of income, and once the investment was made, no

further expenditure was necessary for the production of its income from the investment; and (ii) section 10(b) also precluded any such deduction as claimed. The assessor treated the interest income under section 6(1)(e) of the Income Tax Ordinance 1932 (corresponding to section 3(e) of the IRA 2006) and disallowed the deduction of management expenses in producing its interest income in terms of section 9(3) of the Income Tax Ordinance 1932 (correspond to section 25(4) of the IRA 2006). The Commissioner also disallowed the management expenses claimed as deductions from the income of the company and the Board of Review confirmed the determination of the Commissioner.

[83] It is relevant to note that there was no dispute in the CFI case that the appellant company though functioning as an investment company only, and that the investment was the purpose for which it was formed, it still continued to carry on business in the way of a holding company. The issue in CFI case was whether the management expenses (such as Directors', Secretaries' and Auditors' fees) could be deducted from its income derived from dividends and interest in ascertaining the assessable income of the company under section 9(1) of the Income Tax Ordinance 1932 (corresponding to section 25(1) of the IRA 2006). The CFI judgment dealt with the following two issues:

1. Whether the income derived from dividends and interest was a source under section 6(1)(a) or section 6(1)(e) of the Income Tax Ordinance, 1932;
2. Even if the appellant company was carrying on a business and for that reason, came under section 6(1)(a), was entitled to deduct the management expenses derived from dividends and interest in ascertaining the net profits and income, whether under section 9(1) or 9(3) of the Income Tax Ordinance;
3. Even if the appellant company was carrying on a business and for that reason, came under section 6(1)(a), and the gain derived from dividends and interest falls within the words "dividends, interest or discounts" of section 6(1)(e), whether the Income Tax officer was entitled to elect under which heads 6(1)(a) or 6(1)(e), it will make its assessment.

Whether, in terms of the CFI judgment, the income derived from dividends, interest or discounts falls within the words "profits from any business" under section 6(1)(a) or within the terms "dividends, interest or discounts" under section 6(1)(e) of the Income Tax Ordinance, 1932,

[84] The first question that was considered by the judges in the CFI case was whether the income derived by the company from dividends and interest was a source under section 6(1)(a) or section 6(1)(e) of the Income Tax Ordinance, 1932, which corresponds to section 3(a) and 3(e) of the IRA, No. 10 of 2006 respectively.

[85] The argument of the Appellant in that case was that income should have been assessed under section 6(1)(a) of the Ordinance as a business and therefore, such expenses should have been allowed under section 9(1) (current section 25(1) of the IRA 2006) as "all outgoings and expenses incurred by such person in the production thereof. The Crown argued that the profits or income of the assessee came exclusively under section 6(1)(e) (current section 3(e) of the IRA) and could not be regarded as the profits and income of a business. Alternatively, the Crown argued that if the profits and income came under both under section 6(1)(a) and under section 6(1)(e), the Crown had an option as to the sub-section under which the tax could be charged.

[86] It may be noted that section 9(1) of the Income Tax Ordinance, which relates to the deductions allowed in ascertaining profits or income, is identical to section 25(1) of the IRA. It reads as follows:

> *"(1) Subject to the provisions of subsections (2), and (3), there shall be deducted, for the purpose of ascertaining the profits of income of any person from any source, all outgoings and expenses incurred by such person in the production thereof…."*-

[87] Section 9(3) of the Income Tax Ordinance is identical to section 25(4) of the IRA 2006 and it reads as follows:

> *"(3) Subject as hereinafter provided, Income arising from interest shall be the full amount of interest falling due, whether paid or not, without any deduction for outgoings or expenses:"*

[88] Section 10) (b) of the Income Tax Ordinance reads as follows:

> *"For the purpose of ascertaining the profits or income of any person from any source, no deduction shall be allowed in respect of ……,*
>
> *(b) any disbursements or expenses not being money expended for the purpose of producing the income".*

[89] In the light of those facts and the arguments advanced on behalf of the assessee and the assessor, the Supreme Court proceeded to consider first, whether the source of profits and income of the assessee in that case fell within

the meaning of section 6(1)(a) or section 6(1)(e) of the Income Tax Ordinance. The judges in the CFI case then proceeded to lay down tests for determining whether interest was a source of income under section 6(1)(a) or 6 (1)(e) of the Income Tax Ordinance. Howard C.J., Keuneman J. and Soertsz J. delivered separate judgments, and De Kretser, J. did not deliver a separate judgment, but agreed with the judgment of Soertsz, J. Wijewardene, J. delivered a brief judgment, but agreed with the reasoning of Keuneman J.

[90] It is relevant to note that in the CFI judgment, both Howard C.J., and Keuneman J. recognized that the income derived from dividends and interest falls within the words "profits from business" under section 6(1)(a), or within the terms "dividends, interest or discounts" under section 6(1)(e) of the Income Tax Ordinance (pp. 7, 8, & 19). Howard, C.J. then proceeds to consider in what circumstances will interest be a source under section 6(1)(a) or under section 6(1)(e). In order to determine this question, Howard C.J. laid down the following test at page 250 of the judgment:

> "*If the business of a company consists in the receipt of dividends, interest or discounts alone or if such a business can be clearly separated from the rest of the trade or business, then any special provisions applicable to dividends, interest or discounts must be applied. Applying the principle laid down in the Egyptian case, the appellant company is within source (e) and cannot get out of it. To take such a view does not in any way disturb the scheme of the Ordinance. I agree, therefore, with Keuneman J. that the Commissioner was empowered to charge the appellant Company under section 6 (1) (e) in respect of the dividends and interest received from undertakings in which its capital was invested"* (Emphasis added).

[91] Howard C.J. held that the company is within source (e) and cannot get out of it and therefore, the Commissioner was empowered to charge the company under section 6(1)(e) in respect of dividends and interest received from undertakings in which its capital was invested (p 11). Howard C.J. then proceeded to consider whether the **management expenses** are deductible under section 9(1) as outgoings and expenses incurred "in the production of the profits. Howard C. J. held that as section 9(1) employs the word "any source", it must be regarded as having reference to section 6(1). Accordingly, Howard C.J. opined that "the **management expenses** of the appellant company are deductible as incurred in the production of the profits" (p. 7.

[92] Keuneman, J., while disagreeing with Howard, C.J. on the option available to the Income Tax Commissioner, however, agreed with the test adopted by

Howard C.J. Keuneman J. first proceeded to consider in what circumstances will interest be a source under section 6(1)(a) or under section 6(1)(e). KeunemanJ., laid down the following test at pp. 261-262 of the judgment:

> *'How then are we to treat income which comes under source (e) but can also be regarded as coming under source (a)? In my opinion, it was the intention of the Ordinance to regard dividends, interest or discounts as a separate source. If then the business of an individual or a company consists in the receipt of dividends, interest or discounts alone, or if the business of receiving dividends, interest or discounts can be clearly separated from the rest of the trade or business, then any special provisions applicable to dividends, interest or discounts must be applied. I do not think any question of opinion arises.*(Emphasis Added).

Option of the Income Tax Officer to elect the source of income under section 6(1)(a) or 6(1)(e)

[93] On the question whether the Crown had an option to elect the source of income, the majority of the Judges, comprising Keuneman J., Soersz J. and Kretser J. held that the Crown had no option to elect whether it will assess under section 6(1)(a) or 6(1)(e). Keuneman, J. specifically stated at p. 20 that section 47 of the Income Tax Ordinance, which corresponding to section 99 of the IEA 2006 lends support to this view.

Deduction of Management Expenses

[94] The next question in the CFI case was whether management expenses were incurred in the production of profits and deductibles under section 9(1) of the Income Tax Ordinance. The deductions claimed by the Appellant in the CFI case were "outgoings and expenses incurred in the production" of the profits or income within the meaning of section 9(1) of the Income Tax Ordinance. The Crown argued that the management expenses were not incurred in the production of profits and income. It was not in dispute that though the appellant company in the CFI case was formed as an investment company, it carried on business in the way of a holding company and that everything that accrued to the company, in the course of its business, by way of pecuniary gain, whether by way of dividends, interest, discounts or some other thing falls within the words "profits from any business".

Expenses incurred in earning dividends

[95] Both Howard C. J, and Keuneman J. turned to the management expenses incurred in relation to dividends, arising from the production of income and

held that they are necessary and reasonable expenses (p. 22). Howard C.J. and Keuneman J. recognized that section 9(1) which relates to ascertaining of profits and income of any person applies to "all the sources" of income set out in section 6(1), but places interest on a different footing under section 6(1)(e), if such interest can be separated from the rest of the trade or business.

[96] Howard C.J. having regard to the facts of the case, held that the income derived by the Appellant from dividends and interest falls within the meaning of section 6(1)(e) of the Income Tax Ordinance, and the management expenses can be deducted as outgoings and expenses incurred in the production of income and profits under section 9(1). Howard C.J. agreed with Keuneman J. that the Commissioner was empowered to charge the company under section 6(1)(e) in respect of dividends and interest received in the production of profits and income under section 9(1) of the Income Tax Ordinance.

[97] As far the deduction of management expenses in relation to **dividends,** which the company obtained was concerned, Keuneman J. rejected the submission of the Crown that the company has not done anything to produce the income or profits under section 9(1). Keuneman J., held that section 9(1) "would therefore *prima facie* apply to all the sources in section 6(1)(a) to (h)" (p. 21). Keuneman J., further rejected the argument of the Crown that nothing has been done by the company to produce the income or profits, and held that "the management expenses claimed in the case have been incurred in the production of the income. Keuneman J., further held that the management expenses incurring in the production of income can be deducted from any source, including from source 6(1)(e) and agreed with Keuneman J. that management expenses incurred by the company could be deducted under section 9(1) of the Income Tax ordinance.

[98] Keuneman J. decided that the management expenses can be deducted as far as they relate to the **dividends** which the company obtained in producing the profits or income under section 9(1) of the Income Tax Ordinance 1932.

Expenses incurred in the production of interest-special considerations

[99] In relation to the interest, it was the opinion of Keuneman J. that though the interest is a separate source under section 6(1)(e), that source is subject to "all outgoings and expenses incurred ……in the production of the profits or income, and thus, they must be deducted" (p.21). Keuneman J. then turned to the deduction of **interest income** earned by the company and referred to

section 9(1) and 9(3) of the Income Tax Ordinance. Section 9(1) refers to the deductions for the purpose of ascertaining the profits or income from any source, all outgoings and expenses incurred by any person in the production thereof, and section 9(3) refers to income arising from separate interest, whether paid or not, without any deduction for outgoings or expenses.

[100] Keuneman J. held that had the earning of interest been the **sole and separate business of the company**, the **special provision in section 9(3)** (corresponding to section 25(4) of the IRA 2006) would apply. Keuneman J. however, refused to apply the special provision in section 9(3) on the basis that the company carried **on one business**, **which has two branches**, viz. the earning of dividends and earning of interest, but the interest is only a **subsidiary part of the business**, which is not separated from its ordinary financial business. Accordingly, Keuneman J., refused to apply the special provision in section 9(3), which corresponding to section 25(4) of the IRA 2006. But His Lordship applied the general rule if deduction under section 9(1), which corresponds to section 25(1) of the IRA 2006. The findings of Keuneman J. at p. 22 of the judgment read as follows:

> *"What is the position as regards the items of interest earned by the company? Had the earning of interest been the sole or separate business of the company, no doubt the special considerations under section 9(3) would have been applicable. But it is clear in this case that the company carries on one business, which has two branches, viz., the earning of dividends and the earning of interest, and it is clear on the figures available to us (see Document X) that interest is only a subsidiary part of the business, and is not separated from its ordinary financial business. The interest is "embedded" in the business (in the words of Rowlatt J.) or "a mere incident" in the business (in the words of Lord Hanworth M.R.)-see Butler v. The Mortgage Company of Egypt, Ltd. I do not think it can be separated off or identified as distinct from the general business of the company. I do not* ***think therefore that these items are assessable as such. The ordinary rule under section 9(1) therefore applies and the deductions claimed can be allowed in their entirety*** *[emphasis added].*

[101] On the question whether or not the deductions mentioned in the general rule under section 9(1) (corresponding to section 25(1) of the IRA) apply to all "sources" of income under section 6(1), KeunemanJ. held that the deductions mentioned in section 9(1) apply to all "sources of profit and income" in the following words (p. 23):

"I only repeat that the deductions mentioned in section 9 apply to all "sources" of profit and income".

[102] It is relevant to note that Keuneman J. took the view that section 9(3) applies where the interest is a separate source which is not embedded in the in its general activities in producing its aggregate income and refused to apply section 9(3) as the income was embedded in its general activities in producing its aggregate income.

[103] Having considered the word "any source" which is employed in section 9(1), which refers to either 6(1)(a) or 6(1)(e), Keuneman J. deducted the management expenses in relation to interest earned by the company under the general rule in section 9(1) (correspond to section 25(1) of the IRA) and not under the special rule in section 9(3). On that basis, the deduction of management expenses claimed arising from interest was allowed as outgoings and expenses incurred in the production of the income under section 9(1), which corresponds to section 25(1) of the IRA 2006.

[104] Applying the said principles of law, Keuneman J. finally allowed the appeal and deducted the management expenses incurred in the production of income in relation to dividends and interest in ascertaining the assessable income of the company under section 9(1) (correspond to section 25(1) of the IRA).

[105] The combined effect of the test applied by Howard CJ., and Keuneman J. (with Wijewardene, J. agreed) was that "if the business of a company or individual consists in the receipts of dividends, interests or discounts alone, or if such business can be clearly separated from the rest of the trade, business, then section 3(1)(e) will apply. In other words, if the business of a company or an individual consists in the receipts of dividends, interest or discounts and such business cannot be separated from the rest of the trade or business, and the interest is embedded in the business, such interest or dividends or discounts falls within the meaning of section 3(1(a) of the Act.

[106] The test adopted by Howard CJ., and Keuneman J. applies to identify in what circumstances will dividends, interest or discounts be a source under section 6(1)(a) or under section 6(1)(e). That test has no application to the deductions of expenses mentioned in section 9(1) or 9(3), which relate to statutory exemptions. Accordingly, the CFI judgment ultimately determined the deduction of expenses derived from dividends and income separately by the application of the general rule under section 9(1) and the special deduction rule

under section 9(3). Both Howard CJ., and Keuneman J. confirmed that though the source of income falls under section 6(1)(e), which stands on a different footing in section 6(1), section 9(1) applies to all sources, whether under 6(1)(a) or 6(1)(e) and thus, to all outgoings and expenses incurred in the production thereof. Accordingly, the management expenses incurred in the production of income or profits earned from dividends and interest were held to be deductible under the general rule in section 9(1).

[107] It is relevant to note, however, that Soertsz J. (with whom de Kretser J., agreed) disagreed with Keuneman J. that it was the intention of the Ordinance to regard dividends, interest or discounts as a separate source (p. 252). Soertsz J. held that the question whether the receipt was profits from dividends or interests or discounts falls within section 6(1) or 6(1)(e), and depends on whether or not the **assessor deals with the profits of a "business"** or the **income of an "individual**". Soertsz J. held that where it is appertaining to an income of a business, it falls within 3(1)(a), and where it is related to an income of an individual, as part of his business, it falls within section 6(1)(e). The relevant passage of the judgment at p. 252 reads as follows:

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

[108] The above passage of the judgment of Soertsz J. suggests that the following test would apply to identify whether the profits and income of an individual or business fall within section 3(1)(a) or 3(1) (e):

1. If the profits or income received from dividends or interest or discounts appertains to the business, it will fall within the profits of any business under section 6(1)(a);
2. If the profits or income received from dividends or interest or discounts accruing to an individual was earned, not in the course of a business, but as a part of his income from simple investments, it falls within section 3(1)(e).

[109] The test applied by Soertsz J. that section 6(1)(e) is limited to an income of an "individual" and section 6(1)(a) is limited to the profits of any "business" is not, in my view consistent with the scheme of the IRA 2006, which does not restrict the application of section 3(1)(e) to an individual. In my view, the tests laid down by Howard CJ., and Keuneman J., are significant to identify the source of profits or income under which chargeability arises and to decide in what circumstances, will the dividends, interest or discounts be a source under section 3(a) or 3(e). The identification of the source of profits or income is also significant to apply the general rule of deduction under section 25(1) or special rules of deduction under section 25(1)(a) -(w) of the IRA 2006 to a particular sources or profits or income, irrespective of whether the source falls under section 3(a) or 3(e) of the IRA 2006.

[110] If the business of a company or individual consists in the receipts of dividends, interests or discounts alone, or if such business can be clearly separated from the rest of the trade, business, then section 3(1)(e) will apply. In other words, if the business of a company or an individual consists in the receipts of dividends, interest or discounts and such business cannot be separated from the rest of the trade or business, and the interest is embedded in the business, such interest or dividends or discounts falls within the meaning of section 3(1(a) of the Act.

[111] Applying the above principles adopted in the majority decision of the CFI judgment, we will now proceed to consider whether the interest income earned by the Appellant falls within the words "profits from any business" under section 3(a) or under the term "interest" under section 3(e) of the IRA 2006 and if so, whether the tax exemption conferred by clause 8(1) of the Agreement is wide enough to encompass such profit or income of the Appellant specified in the Agreement.

[112] In this regard it is significant to understand the distinction between the business income and the interest income of the Enterprise earned from different sources of income of the Enterprise. The appellant contends that as the interest received from short term deposits in the interest bearing account for working capital requirement is part of the business or bears a close proximity to the business, the nexus between the interest earned from such short term deposits is wide enough to cover the exemption under clause 8(1) of the Agreement. It is relevant to consider the nature of the interest income received by the Appellant. The first issue that arises concerns the determination of the nature

of the receipt by way of interest. The question is whether the interest earned by the Appellant can be characterized as business income or interest income derived from other sources.

Interest bearing Account and generating interest income

[113] The Appellant's position is that it operated an interest bearing account and received interest income from short term call deposits and utilized for the working capital requirements of its business which is an activity contemplated by the Agreement. An interest-bearing account is a type of bank account that pays the customer an interest rate in exchange for them depositing their money at the bank. The return and interest rate offered will vary by bank and depend on the account terms and conditions (https://www.bankinter.comBanca.financial.dictionary). It (i) facilitates the withdrawal facility and earns high interest on the remaining balance amount and serves a dual purpose for banks and customers; (ii) earns interest on the ideal cash, and to give out loans; and (iii) allows customers to earn high-interest rates by depositing some money (https://www.wallsttreetmojo.com/interest-bearing-account/).

Short term call deposits and utilized for the working capital requirements

[114] Call Deposits are short term deposit accounts requiring usually 7 days notice for the withdrawal of funds by which a higher rate of interest can be earned within a short time span and even instant withdrawals can be made at reduced rates (https://www.combank.lk/business-banking/domestic/call-deposits).The Appellant relies on the recitals of the Supplementary Agreement No. 184 (E) and argues that the working capital is part of the business or is connected with its business. The recitals of the Supplementary Agreement states:

> *"AND WHEREAS the Enterprise by it's letters of 11th April, 1994 and 27th April, 1994 sought approval of the Board for Flagship Status to the Enterprise and the Board having taken into consideration the fact that the Enterprise has invested not less than USD One Hundred and Seventy Nine (179) Million or it's equivalent in any other foreign currency to meet the cost of establishing the said Enterprise and it's working capital resolved to approve the granting of and hereby grants Flagship Status to the Enterprise subject to the terms and conditions in the said Agreement and those contained herein".*

[115] A working capital requirement **(WCR)** is the amount of money required to cover the operating costs and it represents the company's short-term financial requirements. These requirements are caused by gaps in cash flows (money coming in and out) corresponding to cash inflow and cash outflow linked to the business operation (https://agicap.com/en/article/working-capital-requirement-wct).

[116] The recitals however, relate to the approval granted to the flagship status having satisfied its investment in a sum of USD One Hundred and Seventy Nine (179) Million or it's equivalent in any other foreign currency to meet ting the cost of establishing the said Enterprise and it's working capital **subject however, to the terms and conditions in the said Agreement** and those contained in the recitals. The requirement of the minimum investment and working capital requirement is to grant the **flagship status** and is subject to the terms of the BOI Agreement, which clearly provides that the business is related to the commercial airline providing international transportation and all other ancillary and related services connected with international air transportation.

Flagship status

[117] A flagship status is not defined in the Supplementary Agreement. A flagship is, however, a transport company, such as an airline or shipping company, that, being locally registered in a given sovereign state, enjoys preferential rights or privileges accorded by the government for international operations (https://en.wikipedia.org/Flagship). It seems to me that the minimum investment and working capital requirement were qualifications for the grant of the flagship status of the Appellant and thus, it does not alter the definition of "business" in the recitals of the principal agreement. This makes it clear that the tax exemption covers the business income of the Appellant in connection with or in relation to the said business of the Enterprise engaged in operating or providing international air transportation; and all other ancillary and related services concerning the international air transportation including but not limited to ground handling services referred to in the applications dated 5th, May, 13th May and 21st May, 1980.

[118] As noted, the recitals in the principal agreement and Part I of the principal agreement set out the nature of the approval sought by the Appellant and the nature of the approval granted by the BOI to conduct business in accordance

with such application. The Appellant has sought approval from the BOI to set up/conduct and operate its business as a commercial airline providing international air transportation and all other ancillary and related services thereto including but not limited to Ground Handling Services referred to in the said application. The BOI has thus granted approval to the Appellant to conduct the following business activities as set out in Part I of the Agreement:

> "*1. Right to operate*
>
> *The Enterprise shall be entitled to and shall set up/conduct and operate the aforementioned business in accordance with the undertakings reputations, commitments and proposals made by the Enterprise and set out in its applications dated 5th, 13th, and 21st May 1980 and as set out in this agreement and all correspondence in therewith including those enumerated in the first schedule hereto and subject to the terms and conductions hereinafter provided* and subject to the provisions of the said Law, No. 4 of 1978…..

[119] It is manifest that the BOI has granted approval for the business of operating and conducting commercial airline providing international air transportation; and all other ancillary and related services thereto (international air transportation) including but not limited to ground handling services. The tax exemption has been given to the profits and income generated by the said business and all other ancillary and related services of international air transportation. The tax exemption is thus limited to the business income of the Appellant earned in respect of its profits and income generated from the business of operating a commercial airline providing international air transportation and related services thereto, which also means air transportation. The tax exemption is not extended to all other income earned by the Appellant from other sources, which is not connected with the commercial airline providing international air transportation, providing and related services thereto.

[120] The words "in connection with and/or in relation thereto" in clause 8 of the principal Agreement thus cover the services which the Appellant provides in international air transportation and related air transportation services under the Agreement such as transportation of passengers, cargo, airline ticketing, bookings, ground handling services, and all other ancillary air transportation services. The tax exemption does not cover all other activities and income earned by the Appellant which are not connected with or related to the

business of a commercial airline providing international air transportation and related services.

[121] The Appellant has operated an interest-bearing bank account for depositing its working capital money in the bank to earn a higher interest income from such short term call deposits, which is not connected with or related to its business of commercial airline providing international air transportation and related services. The interest income earned by the Appellant from an interest bearing account is a separate source of income not connected with the profits and income earned by the Enterprise from its business for which the tax exemption has been granted by the BOI.

[122] In my view, to sustain the submission of the Appellant, and obtain the benefit of the exemption, it was just not sufficient that a commercial connection was established between the profits earned from short term deposits and its business of air transportation. In my view the business of air transportation itself had to be the source of the profit or income derived from short term deposits and the business had the direct source of the interest income earned from such short term deposits and not a means to earn any other profit. The interest income received from short term call deposits has been derived from a different source under section 3(e) and thus it can be clearly separated from the business of commercial airline providing air transportation and ancillary or related services. In my view, such interest income cannot be categorized as business income of the Appellant under section 3(1).

[123] the other hand, the interest from short term deposits received by the Appellant is not the direct result of any business of the commercial airline providing air transportation though it can be attributed to a commercial connection, and hence, it cannot be treated, in the absence of direct evidence including the entries made in the statement of accounts as income which is derived from the business income of the Appellant. The mere statement without proof that the interest income was used for working capital requirement is not sufficient to categorise such income as part of the business income to which the tax exemption was conferred under clause 8(1) of the Agreement.

[124] The Appellant's contention was that its short term interest income earned was used for its working capital requirements and, therefore, such interest

income is connected with or related to its business set out in the BOI Agreement. The BOR has stated in its determination that the Appellant has failed to establish that the funds from the interest bearing account were used for the working capital requirements of the Appellant's airline's operation. The relevant findings of the BOR at p. 8 of the determination read as follows:

> *"The Appellant has not led any evidence of a witness like company accountant or any other competent person before the Board to explain and establish funds of those accounts had been withdrawn and used in the business of Air Line operation. The fact that the account was opened for a short period does not mean that the fund or the deposit had been employed and risked in the trade. It appears from the accounts that out of the profits of the company for the relevant period (before taxation), the interest component is a substantial which can stand as a sizable source of income of the company. The total profits before taxation as appearing in document marked (profits and loss) accounts for the year ended 31st March 95/96 is Rs. 431.74 million and Rs. 29.8 million for the year 1995 and 1996 respectively. The contribution of the interest to the company's profits is Rs. 96.66 and Rs. 251.86 for the respective years".*

[125] No evidence has been placed before the BOR to prove that the income earned from such short term deposits bears a direct nexus to the business activity itself. I accordingly hold that interest earned on short term call deposits, does not have an immediate nexus with the business of air transportation or ancillary services, and therefore it has to be treated as income from other sources, and not business income. I am unable to accept the contention of the Appellant that interest earned on short term call deposits should qualify as business income which covers the exemption conferred under clause 8(1) of the agreement.

[126] I hold that the interest income earned from short term call deposits cannot be characterized as income from the business of operating a commercial airline providing international air transportation and related air transportation services. For those reasons, I hold that the exemption granted by the BOI Agreement does not extend to the interest income of the Appellant's Enterprise and therefore, the Appellant's claim to the exemption conferred by the BOI Agreement. The Question of Law, No. (d) is answered accordingly in favour of the Respondent.

Question of Law, No. (e)

Deductions for losses brought forward to an assessment year in which the tax exemption applies

[127] The Appellant claimed that the loss brought forward from the year of assessment 1993/1994 amounting to a sum of Rs. 192,464,632/- (which includes pre-operational interest amounting to a sum of Rs. 88,236,632/- for the year of assessment 1992/1993 and Rs. 105,601,382/- for the year of assessment 1993/1994) should be deducted under section 29 of the Inland Revenue Act, No. 28 of 1979. It is the contention of the Appellant that the pre-occupational interest relates to interest payable on loans obtained to acquire capital assets, and such interest is not deductible under section 23 but it is claimable under section 29 of the Inland Revenue Act, No. 28 of 1979.

[128] The Appellant concedes that since the Appellant enjoys a tax exemption conferred by the BOI, its profits and income from the exempt business are not subject to the imposition of the Inland Revenue Act. The Appellant's argument is, however, that since the Appellant has a total statutory income within the contemplation of section 25 of the Inland Revenue Act, No. 28 of 1989, the pre-operational interest incurred by the Appellant should be allowed as a deduction from statutory income as claimed in the return. Section 29 (2) of the Inland Revenue Act, No. 28 of 1979 reads as follows:

> *"(2) There shall be deducted from the total statutory income of a person for any year of assessment-*
>
> *(a) sums payable by him for that year of assessment by way of annuity, ground rent, royalty or interest not deductible under section 23 :*
>
> *Provided that-*
>
> *(i).....*
>
> *(ii) Where for any year of assessment any sums so payable exceed the total statutory income for that year, the excess shall be treated for the purposes if this section in the same manner as a loss incurred in a trade of that sum";*

[129] The Board of Review has taken the view that the Appellant is not entitled to claim deductions for losses brought forward to an assessment year in which the tax exemption applies under the BOI Law and accordingly, the provision of

section 29 of the Inland revenue Act, No. 28 of 1979 is inoperative and inacpplicable. The findings of the BOR are as follows:

> *"Finally, the claim under section 29 of the Act as being interest on a loan taken to purchase certain air crafts are not deductible because there air crafts have been acquired to be used in the business to which exemptions are applicable under GCEC Law. When the applicability of Inland Revenue Act is removed, the provisions relating to the whole income taxation os inoperative and inapplicable".*

[130] Dr. Felix argued however, that pre-operational interest represents interest incurred by the Appellant in connection with aircraft that had not been put into operation during the relevant year of assessment and therefore, the said interest cost would not have been taken into consideration under section 23 of the Act, when computing the taxable profits and would not come within the scope of the BOI tax exemption. He submitted that the tax exemption applies only to the income from the specified business and not the whole of the profits and income and since the Appellant has taxable profits and income, it also has a total statutory income, within the contemplation of section 25, it is entitled to a statutory deduction permitted under and in terms of section 29(2) of the Inland Revenue Act, No. 28 of 1979.

[131] It was the contention of Dr. Felix that prior operational losses relating to the year of assessment 1983/1984 constitute preoperational interest which is a deductible sum and in support of the said position, he relied on the decisions of the Court of Appeal in *Commissioner General of Inland Revenue v. Seylan Bank PLC*, CA Tax 10/2014 decided on 06.04.2017, *Setmil Developers Lanka (Pvt) v. Commissioner General of Inland Revenue* CA Tax 27/2019 decided on 03.02.2022 and *Commissioner General of Inland Revenue v. Holcim Lanka Limited* CA Tax 18/2015 decided on 09.09.2022. His main contention was that despite the BOI tax exemption, the Appellant has a total statutory income and the losses arising from the preoperational interest cost which is lawfully deductible under and in terms of section 29 (2) of the Inland Revenue Act, No. 28 of 1979.

Tax exemption period and the year of assessment during which the brought forward losses claimed

[132] In *Commissioner-General of Inland Revenue v. Seylan Development PLC (supra),* the Respondent entered into an agreement with the BOI and clause 10

(1) of the said agreement provided a tax exemption clause. The Respondent in that case sought to deduct the loss incurred in the year 1998/1999 from the total statutory income as that loss could have been assessable under section 32 (5) (b) of the Inland Revenue Act, No. 10 of 2006. The Court of Appeal was called upon to decide the single question: "when does the tax holiday period commence?" In other words, the question was: "Is it the date determined by the Assessor or it is the date determined by the BOI which has been confirmed by the Tax Appeal Commission". His Lordship Surasena, J. held that:

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

[133] Having perused the certificate which confirmed that the Respondent complied with the investment criterion as required by clause 10 (1) of the said agreement, the Court of Appeal held that the tax exemption period commenced from 01.04.2003 to 31.03.2008 and the year of assessment occurred in the year 1998/1999 and the Court of Appeal held :

> *"Such profits would become non assessable only if that year of assessment namely 1998/1999 becomes a year during the period of the tax holiday granted by the BOI. Thus, the next question that arises for consideration is whether that year namely 1998/1999 is within the period of tax holiday as per the agreement between the Respondent and the BOI".*

[134] The Court of Appeal proceeded to consider the question whether the year of assessment 1998/1999 is within the period of tax holiday as per the agreement and held that the Respondent was entitled for the tax holiday period of 5 years commencing from **01.04.2003 to 31.03.2008**, and the loss

had occurred in the year of assessment 1998/1999 and therefore, the year of assessment is not within the tax holiday period determined by the BOI and any profit that may have been made during that year of becomes assessable UNDER THE Act as the tax exemption does not apply to that year. His Lordship Surasena, J. held at page 16:

> *"These facts clearly show that the year of assessment 1998/1999 is not qualified to be a year of tax exemption as it has not met any of the two requirements set out above. Therefore, the year of assessment 1998/1999 is not within the tax exemption period determined by the BOI. Thus, any profit that may have been made during that year becomes assessable under the Act as the tax exemption does not apply to that year. Therefore, any loss that the Respondent had incurred in the year 1998/1999 could be deducted from the total statutory income as that amount of the loss could bhave been assessable under the Act if it had been a profit".*

[135] Accordingly, the Court of Appeal held that any loss that the Respondent had occurred in the year 1998/1999 could be deducted from the total statutory income as that amount of the loss could have been assessable under the Act if it had been a profit.

[136] In *Setmil Developers Lanka (Pvt) Ltd v. Commissioner of Inland Revenue* C.A./Tax No. 27/2019 decided on 22.03.2022, tax exemption period commenced from **01.04.2009 to 31.03.2010** and the year of assessment was **2008/2009** in which the loss occurred during the year of assessment 2008/2009, which was prior to the tax exemption period (01.04.2009 to 31.-3.2010). The question involved in *Setmil Developers Lanka (Pvt) Ltd v. Commissioner of Inland Revenue (supra)* was the deductibility of the tax losses incurred by the Appellant during the period of commercial operations, but prior to the commencement of the tax exemption period (by carrying them forward to the subsequent year of assessment from the previous year under section 32 (5) (a) of the Inland Revenue Act, No. 10 of 2006. While endorsing the decision of the Court of Appeal in *Commissioner-General of Inland Revenue v. Seylan Development PLC (supra), the Court of Appeal in Setmil Developers Lanka (Pvt) Ltd v. Commissioner of Inland Revenue (supra) held that:*

> *"As the year of assessment 2008/1009 (01.04.2008 to 31.03.2009) does not fall within the tax exemption period determined by the BOI, any profit that may have been made by the Appellant during that year of assessment 2008/2009, does not fall under the BOI Agreement. The year of assessment*

2008/2009 is not qualified to be a year of tax exemption under clause 12(i) of the BOI Agreement as it occurred prior to the tax exemption period 2009/2010 determined by the BOI. Accordingly, the loss of Rs. 29,453,164/- incurred during that year of assessment (2008/2009) and prior to the tax exemption period (2009/2010) becomes assessable under the Inland Revenue Act as the BOI tax exemption period does not apply to that year of assessment 2008/2009.

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

[137] In *Commissioner General of Inland Revenue v Holcim Lanka Limited* CA Tax 0018/2015 decided on 09.09.2022, the 12 year tax exemption period commenced from 01.01.2001 and the brought forward losses occurred in the year of assessment 1999/2000, 2000/2001 and 2001/2002. The Tax Appeals Commission decided that the 12 year tax exemption period commenced on 01.01.2001 and brought forward losses claimed in the years of assessments should be computed accordingly. The Court of Appeal confirmed the determination made by the Tax Appeals Commission.

[138] In the present case, the principal agreement dated **28.01.1982** provided that the tax exemption period was 7 years commencing from the date of commencement of commercial operation of the business as determined by the BOI and after the expiry of the said period the Inland Revenue Act for the time being shall be applicable (clause 8(i)). The Supplementary Agreement No. 25 dated **21.07.1989** provides that the tax exemption period was **10 years reckoned** from the date of which the enterprise is deemed to have commenced commercial operations and the provisions of the Inland Revenue Act, No. 28 of 1979 relating to the imposition, payment and recovery of income tax in respect of profits and income shall not apply to the profits and income of the enterprise (amended clause 8(i)(a) -page 4).

[139] The Supplementary Agreement No. 32 dated **21.12.1989** provides that the tax exemption period was **15 years reckoned** from the date of which the enterprise is deemed to have commenced commercial operations and the

provisions of the Inland Revenue Act, No. 28 of 1979 relating to the imposition, payment and recovery of income tax in respect of profits and income shall not apply to the profits and income of the enterprise (amended clause 8(i)(a) -page 4). The Supplementary Agreement, No. 184 provides that the tax exemption period is 15 years recknowd from the year of assessment 1983/1984 and the provisions of the Inland Revenue Act, No. 28 of 1979 relating to the imposition, payment and recovery of income tax in respect of profits and income shall not apply to the profits and income of the enterprise.

[140] The total tax exemption period was thus, 15 years commencing from the date of commercial operations or from the year of assessment 1983/84 as the case may be specified in the respective agreements. The Appellant claimed brought forward losses from the year of assessment 1993/1994 amounting to a sum of Rs. 192,464,632/- which includes pre-operational interest for the year of assessment 1992/1993 and for the year of assessment 1993/1994). The losses claimed by the Appellant had occurred in the year of assessment 1993/1994 which is within the tax exemption period determined by the BOI and therefore, any profit that may have been made during that year does not become assessable under the Inland Revenue Act as the tax exemption applies to that year. Therefore, any loss that the Appellant had incurred in the year of assessment 1993/1994 could not have been assessable under the Inland Revenue Act if it had been a profit in terms of the said principal and supplementary agreements.

[141] Now the question is whether pre-operational interest payable on loans obtain to acquire aircrafts which have not been put into operation is a capital receipt as claimed by the Appellant. As noted, for the purposes of section 29 (2), of the Inland Revenue Act, 1979 to apply, it must be assumed that the Appellant's business made a profit in 1993/1994, though in fact it is a loss but such loss may be brought forward to the next year of assessment under section 29 of the Inland Revenue Act. Where the loss occurred not within the tax exemption period determined by the BOI, any profit, though it is in fact a loss, may be brought forward to the next year of assessment and deducted from the statutory income for that year of assessment. In the present case, the loss occurred in the year 1993/1994 which is within the tax exemption period determined by the BOI and thus, profit that may have been made, which is in fact is a loss during that year of assessment is not assessable under the Act as the tax exemption period applied to that year.

[142] Dr. Felix however, sought to argue that the pre-operational interest cost relates to interest incurred on aircraft that have not been put into operation during the relevant period and hence, it cannot be regarded as part of the business to which tax exemption applies under the BOI Agreement. It is not in dispute that the aircraft had been acquired to be used in the business to which the tax exemption applies under the BOI Agreement, which is inextricably linked to the business of the commercial airline providing air transportation services and the loss occurred during the tax exemption period while during the business of the commercial airline providing air transportation services.

[143] If fact, if the profit, which is in fact a loss occurred prior to the tax exemption period, it could be regarded as a capital receipt and hence, it may be required to be set off against pre-operation expenses on aircrafts. No material is available to indicate that the pre-operational interest costs related to interest that have not acquired during the tax exemption period and used prior to the tax exemption period and such interest are not connected with the business of the air transportation. Merely because some aircrafts were temporarily parked and not put into operation during the relevant year, it cannot be said that the claimed interest cost was not connected to the business to which the tax exemption does not apply and hence, it can be deducted under the Inland Revenue Act

[144] The BOR correctly took the view that the aircraft was acquired to be used in the business of the Appellant to which the exemption applies and hence, provisions of the Inland Revenue Act are inapplicable. The relevant findings of the BOR are as follows:

> *"Finally, the claim under section 29 of the Act as being interest on a loan taken to purchase certain air crafts are not deductible because these aircrafts have been acquired to be used in the business to which exemption is applicable under GCEC law. When the applicability of the Inland Revenue Act is removed, the provisions relating to the whole income taxation is inoperative and inapplicable".*

[145] For those reasons, I hold that the losses occured during the tax exemption period cannot be carried forward and deducted under section 29 (2) of the Inland Revenue Act, No. 28 of 1979 in an year of assessment where the provisions of the Inland Revenue, No. 28 of 1979 are deemed to be inapplicable by virtue of the BOI Agreement.

Conclusion & Opinion of Court

[146] For those reasons, I answer questions of law arising in the Case Stated as follows:

a) No

b) The Board of Review had made the determination of the appeal within a period of two years from the date of oral hearing which commenced on 08.01.2008 as required by the proviso to section 140(10) of the Inland Revenue Act, No. 38 of 2002 as amended by the Inland Revenue (Amendment) Act, N0. 37 of 2003. However, the Board of Review was prevented from hearing the appeal in respect of the year of assessment **1994/1995** in view of the failure of the Commissioner General to hear the appeal within a period of three years from the date of the receipt of the appeal as required by section 117(12) of the Inland Revenue Act, No. 28 of 1979 (as amended) or refer the appeal for the year of assessment **1994/1995** to the BOR within the said stipulated period of three years;

c) Yes (see also the answer to the Question of Law No. (b), and reasons for this determination).

d) No

e) No

[147] For those reasons, I annul the assessment made by the Board of Review dated 22.10.2009 for the year of assessment **1994/1995** and confirm the determination made by the Board of Review dated 22.10.2009 for the year of assessment **1995/1996**. The Registrar is directed to send a certified copy of this judgment to the Tax Appeals Commission.

JUDGE OF THE COURT OF APPEAL

M. Sampath K.B. Wijeratne, J.

I agree.

JUDGE OF THE COURT OF APPEAL