

28/1962

IN THE PRIVY COUNCILNo. 21 of 1962ON APPEAL
FROM THE SUPREME COURT OF CEYLONB E T W E E NTHE COMMISSIONER OF
INLAND REVENUEAppellant

- and -

A.W. DAVITH APPUHAMY Respondent

UNIVERSITY OF LONDON
INSTITUTE OF ADVANCED
LEGAL STUDIES
30 MAR 1963
25 RUSSELL SQUARE
LONDON, W.C.1.

- 68253

CASE FOR THE APPELLANT

- | | | |
|----|--|------------------------------|
| | | <u>Record</u> |
| 10 | 1. This is an appeal from a Judgment and Decree of the Supreme Court of Ceylon, dated the 10th July, 1961, on a Case Stated, under the Income Tax Ordinance (C.188) Section 74, by the Board of Review, Inland Revenue, in respect of a Decision of the said Board, dated the 12th September, 1960. By the said Decision the Board allowed an appeal by the Respondent (hereinafter also referred to as "the assessee") against certain assessments to income tax in respect of the profits of a business owned and carried on by him on the ground that certain legal expenses incurred by him in defending an action had not been deducted in the computation of the said profits. | pp.11-13
pp.1-4
pp.5-8 |
| 20 | | |
| | The Supreme Court, by its said Judgment and Decree, affirmed the Decision of the Board of Review. | p.13, 11.12-16 |
| 30 | 2. The question for determination on this appeal is whether the said legal expenses, incurred by the assessee in the circumstances hereinafter set out, are (as has been held), or are not, deductible for income tax purposes. | |
| | 3. Relevant portions of the Income Tax Ordinance (C.188) are included in an Annexure hereto. | |

Record

4. The facts are as follows :-

p.1, 11.20-27

As from the 28th October, 1945, the assessee carried on the business known as the Kandy Ice Co. and from the year of assessment 1945-46 onwards he has been assessed to income tax on the profits thereof.

p.1, 11.28-31

In November, 1948, one Godamune and two others instituted Case No. X 1233 in the District Court of Kandy against the assessee (the 1st defendant) and several others claiming rights in the said business.

10

The dispute between the parties was thus referred to by the Board of Review in its Decision, dated the 12th September, 1960, (see further paragraphs 11 and 12 hereof) :-

p.7, 11.29-40

"The appellant" (the assessee) "had received certain sums of money from the plaintiffs in D.C. Kandy X 1233 and some others. The plaintiffs claimed that these monies paid to the 1st defendant (the appellant) was the consideration contributed by them for the purchase of the Kandy Ice Co. by a syndicate. The 1st defendant (the appellant) claimed that it was intended to promote a Company to purchase this business from the defendant and the money paid by plaintiff and others was contributed for purchase of shares in the new Company.

20

p.7, 11.37-40

The matter directly in issue in this case was the nature of the monetary transactions between these parties in connection with the said business. It was an adjudication on the rights of the parties to the business and the profits of the business."

30

5. In their amended plaint, filed on the 29th November, 1948, in the said action (D.C. Kandy X 1233) against the assessee and others, the plaintiffs prayed, inter alia :-

p.39, 1.36
to
p.40, 1.8

"(a) For a declaration that the 1st defendant was acting throughout for and on behalf of the said syndicate in the transactions between the 1st defendant and the owners" (of the Kandy Ice Co.) "and that the plaintiffs and 1st to 4th defendants are entitled to all

40

the benefits and advantages resulting from the said transactions.

(b) That the 1st defendant be ordered to submit for execution by the owners of a deed of transfer of the said business with its goodwill and assets (prepared by the 1st defendant or alternatively by the plaintiffs) in favour of the plaintiffs and 1st to 4th defendants or alternatively in favour of the 1st defendant.

(c) As an alternative to the relief prayed for in paragraph (b) above the Court do order the 1st defendant to instruct or request the owners to execute a transfer as aforesaid.

(d) ...

(e) That the accounts be taken of the said business as from 26th October, 1945, and that the Court do order the 1st defendant to render accounts and pay to the said syndicate such sum as the Court finds was the profit earned by the said business in proportion to the sums contributed by the members of the said syndicate respectively."

p.40, 11.16-21

6. Answering the said amended plaint, the assessee (the 1st defendant) in his Answer, dated the 24th June, 1948, stated inter alia that

"(2) ... the business known as the Kandy Ice Co. with all its assets, movable and immovable, was purchased by this defendant who thereupon became the owner thereof, that this defendant was duly placed in possession of the said business and its assets and registered as the owner. The execution of a formal conveyance had to be deferred pending the approval and execution of certain other documents ...

p.45, 11.13-19

(3) ... this defendant says that, after defendant's said purchase, proposals were made by certain persons to form a limited liability Company for the purpose of acquiring from this defendant the said business and its assets; that certain contributions towards the proposed share capital of the proposed Company were made but in consequence of

p.45, 11.21-28

Record

certain differences and disagreements that arose among the prospective shareholders the proposal fell through and was abandoned."

pp.65-70

7. By deed No.114, executed on the 16th August, 1949, the business known as the Kandy Ice Co., together with its goodwill and all other assets (including the lands and premises on which the business was carried on) was conveyed to the assessee.

pp.57-64

8. By its Judgment and Decree, dated the 31st March, 1950, the District Court dismissed the action (D.C. Kandy X 1233) on certain preliminary issues but subsequently this decision was set aside by the Supreme Court and a re-trial ordered.

10

p.72, 1.1

At the re-trial the action was settled on the following terms on the 27th September, 1955.

p.72, 11.4-29

"It is agreed that the 1st defendant is the sole owner as from 1st October, 1945, of all the assets movable and immovable, including the goodwill of the business which was and is called and known as 'The Kandy Ice Co.' which forms the subject-matter of this action. The plaintiffs state that they have not had nor have any right title or interest or claim to or in the assets or goodwill of the business known as the Kandy Ice Co.

20

The 1st defendant agrees to pay to the plaintiffs a sum of Rs.76,500.

The 1st defendant reserves his right, if any, to claim a sum of Rs.6,077.70, which he alleges is due from the 3rd plaintiff and a further alleged claim of Rs. 891.45 as against the 4th plaintiff as administrator of the estate of the deceased 2nd plaintiff. The 3rd and 4th plaintiffs do not admit these alleged claims.

30

Both parties admit that they have no other claims against each other in respect of this transaction either collectively or individually.

40

The plaintiffs are entitled to withdraw from Court the money deposited in Court to this case by the 1st defendant, together with

any dividends and interest declared thereon up to date, in reduction 'pro tanto' of the said sum of Rs.76,500. The balance is to be paid within six months from today without any interest.

Writ to issue in the event of non-payment of the balance with costs of execution, if any.

Each party to bear his own costs of the case up to date."

- 10 9. In defending the said action the assessee stated that he incurred the following legal expenses which he claimed to deduct in computing the profits of the said Kandy Ice Co. which business as stated in the terms of the settlement, formed "the subject-matter of the action" :-
- | | | |
|---------------------|-----|-----------|
| Year ending 31.3.53 | ... | Rs. 3,260 |
| Year ending 31.3.54 | ... | Rs. 1,100 |
| Year ending 31.3.55 | ... | Rs. 2,695 |
- The Assessor disallowed the claim. p.3, 11.7-13
p.6, 11.38-43
- 20 10. The assessee appealed to the Commissioner of Inland Revenue but the Assessor's decision was affirmed by the Authorised Adjudicator appointed by the Commissioner and thereupon the assessee appealed to the Board of Review. p.3, 11.14-19
11. By its Decision, dated the 12th September, 1960, the Board of Review accepted the argument advanced on behalf of the assessee: pp.5-8
- 30 "that the sums of money spent in defending the assets and goodwill of the said business was an expenditure incurred in the production of income and was an allowable deduction under Section 9(1) of the Income Tax Ordinance." p.3, 11.22-25
- The Board rejected (it is respectfully submitted without sufficient reason) the argument advanced on behalf of the Commissioner of Inland Revenue that
- 40 "(i) the legal expenses incurred by the assessee in D.C. Kandy X 1233 was a disbursement or expense not being money expended for the purpose of producing income" - the p.3, 11.28-36

Record

expression used in Section 9(1) of the Income Tax Ordinance - "and the deduction of such expenditure was disallowed under Section 10(b) of the Income Tax Ordinance.

(ii) the legal expenses incurred by the assessee in D.C. Kandy X 1233 was expenditure of a capital nature and the deduction of such expenditure was disallowed under Section 10(c) of the Income Tax Ordinance."

12. In coming to its said Decision, the Board expressed the following views :- 10

p.7, 11.10-28

"If the plaintiffs had succeeded in this litigation the appellant" (i.e. the assessee) "would have become entitled only to a certain share of the income from the business for the past years and only to a share of the income in the future. The result of the litigation would not have affected the profits earned from the Kandy Ice Co. but it could have seriously diminished the income of the appellant from this source. Section 9(1) of the Income Tax Ordinance states 'there shall be deducted for the purpose of ascertaining the profits or income of any person from any source all outgoings and expenses incurred by such person in the production thereof.' The section refers to the profits or income of 'any person'. Whether the deduction claimed under this section should or should not be allowed depends not on whether the expense was incurred on the production of the profits of the Kandy Ice Co. but whether the expense was incurred in the production of the income of the appellant. If the appellant had not defended in Court the claim made against him for shares in the business and a distribution of profits of that business his own income from this source would have been very much less than the assessment made on him in the past." 20 30 40

As to the Board's view that the matter directly in issue in the said case was "the nature of the monetary transactions between these parties", see paragraph 4 hereof.

pp.9-10

13. Dissatisfied with the decision of the Board of Review, the Commissioner of Inland Revenue, by

his Communication, dated the 29th September, 1960, applied to the Board, under Section 74(1) of the Ordinance, to state a case for the opinion of the Supreme Court on the following question of law :-

10 "(1) Is the sum of Rs.3,260 expended by the assessee in defending action No.X 1233 of the District Court of Kandy during the period 1.4.52 to 31.3.52 an outgoing or expense incurred by him in producing the income of the business known as the Kandy Ice Company within the meaning of Section 9 of the Income Tax Ordinance?

((2) and (3) relating to the two other sums of Rs. 1,100 and Rs. 2,695 and to the years 1.4.53 to 31.3.54 and 1.4.54 to 31.3.55, respectively, were otherwise in terms similar to (1) above).

20 (4) Are the said sums of Rs. 3,620, Rs. 1,100 and Rs. 2,695 referred to in Clauses (1), (2) and (3) above, or any of them, disbursements or expenses not being money expended for the purpose of producing the income of the business known as the Kandy Ice Company within the meaning of Section 10(b) of the Income Tax Ordinance?

30 (5) Are the said sums of Rs. 3,260, Rs. 1,100 and Rs. 2,695 referred to in Clauses (1), (2) and (3) above, expenses of a capital nature within the meaning of Section 10(c) of the Income Tax Ordinance?"

14. The case came up for hearing in the Supreme Court before a Bench consisting of Basnayake C.J. and H.N.G. Fernando J. who, by their judgment, dated the 10th July, 1961, confirmed the assessment determined by the Board of Review.

pp.11-13

40 Delivering the main Judgment of the Court, Basnayake C.J. (with whom H.N.G. Fernando J. agreed), after reciting the facts, expressed the Court's decision, without giving any reasons therefor, in the following terms :-

"We agree with the decision of the Board that the legal expenses of the assessee are deductible under Section 9(1) of the Income Tax Ordinance in ascertaining the assessee's

Record

profits from his business the Kandy Ice Company.

We confirm the assessment determined by the Board. The assessee is entitled to the costs of his appeal and a refund of the sums paid under subsection (1) of Section 74 of the Income Tax Ordinance."

p.14

15. A Decree in accordance with the Judgment of the Supreme Court was drawn up on the 10th July, 1961, and against the said Judgment and Decree this appeal to Her Majesty in Council is now preferred, the Appellant having been granted leave to appeal by decrees of the Supreme Court, dated the 25th August, 1961, and the 12th September, 1961.

10

p.17

pp.18,19

In the Appellant's respectful submission the appeal should be allowed and the said Judgment and Decree of the Supreme Court, dated the 10th July, 1961, and the Decision of the Board of Review, dated the 12th September, 1960, should be set aside, with costs throughout, for the following among other

20

R E A S O N S

- (1) BECAUSE the source of income or profits relevant for consideration in this case under Section 9(1) of the Ordinance is the trade of the Kandy Ice Company.
- (2) BECAUSE the deductions claimed were not outgoings or expenses incurred in the production of income or profits from that source.
- (3) BECAUSE such deductions are not authorised under Section 9(1), and are prohibited under Section 10(b), of the Ordinance.
- (4) BECAUSE the legal expenses claimed as deductions arose by reason of the assessee's acquisition of a proprietary interest in the business of the Kandy Ice Company, and his participation in the contentious syndicate.
- (5) BECAUSE such expenses were not incurred by the assessee as a trader.

30

40

- 10
- (6) BECAUSE the issue in the Kandy litigation, (in respect of which the expenses arose), was an adjudication of the rights of the members of the syndicate (including the assessee).
 - (7) BECAUSE the deduction of expenses of that kind is prohibited under Section 10(c) of the Ordinance.
 - (8) BECAUSE there is no, alternatively no sufficient, finding of fact to support the determination of the Board of Review.
 - (9) BECAUSE the Supreme Court was wrong in upholding such determination.

JOHN SENTER.

R.K. HANDOO.

M. KANAGASUNDERAM.

A N N E X U R E

The Income Tax Ordinance (C.188) *

CHAPTER I

Preliminary

2. "Profits or income" means the net profits or income from any source for any period calculated in accordance with the provisions of this Ordinance. Interpretation.

10 "Year of assessment" means the period of twelve months commencing on the first day of April, nineteen hundred and thirty-two, or any subsequent period of twelve months commencing on the first day of April.

CHAPTER II

Imposition of Income Tax

20 5. (1) Income tax shall, subject to the provisions of this Ordinance and notwithstanding anything contained in any other written law or in any convention, grant, or agreement, be charged at the rate or rates specified hereinafter or fixed by resolution under Section 20A, for the year of assessment commencing on the first day of April nineteen hundred and thirty-two, and for each subsequent year of assessment in respect of the profits and income of every person for the year preceding the year of assessment - Incidence of Income Tax

.

6. (1) For the purposes of this Ordinance, "profits and income" or "profits" or "income" means - Income charge-able with tax

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

* C.242 in the Legislative Enactments of Ceylon Vol.VIII Revised 1956 Edition

CHAPTER III

Ascertainment of Profits or Income

Deductions allowed

9. (1) Subject to the provisions of sub-sections (1B), (2) and (3), there shall be deducted, for the purpose of ascertaining the profits or income of any person from any source, all outgoings and expenses incurred by such person in the production thereof, including -

.

(1B)

(2)

10

(3)

Deductions not allowed

10. 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;

(c) any expenditure of a capital nature or any loss of capital;

.

CHAPTER IV

20

Ascertainment of Statutory Income

Basis for computing statutory income

11.

(6) Where a person whether resident or non-resident ceases to carry on or exercise a trade, business, profession, vocation, or employment in Ceylon, or, being a resident person, elsewhere, his statutory income therefrom shall be - and he shall not be deemed to derive statutory income from such trade, business, profession, vocation, or employment for the year of assessment following that in which the cessation occurs:

30

(8) The statutory income of any person ceasing to be resident from any source not being a trade, business, profession, vocation, or employment to which sub-section (6) applies

CHAPTER XI

APPEALS

Appeals to the Commissioner

10 69. (1) Any person aggrieved by the amount of an assessment made under this Ordinance may within thirty days from the date of the notice of such assessment appeal to the Commissioner by notice of objection in writing to review and re- vise such assessment

Procedure on appeals to the Commissioner

69A (1) The Commissioner may authorize any number of persons, besides Assistant Commissioners, to hear and determine appeals made to the Commissioner under Section 69.

Power of the Commissioner to authorize persons, besides Assistant Commissioners, to hear and determine appeals

20 (2) Every person authorized by the Commissioner under sub-section (1) is hereinafter referred to as an "authorized adjudicator".

(3) Each authorized adjudicator shall hear and determine such appeals under Section 69 as may be assigned to him by the Commissioner.

71. (1) Any appellant, or the authorized representative of any appellant, who is dissatisfied with the determination by the Commissioner of an appeal under Section 69, may declare his dissatisfaction with that determination

Right of appeal to the Board of Review

30 (2) Where the appellant has declared or communicated his dissatisfaction in accordance with sub-section (1), the Commissioner shall, within one month of the determination of the appeal, transmit in writing to the appellant or his authorized representative his determination and reasons therefor.

(3) Within one month of the transmission of

such written determination and reasons by the Commissioner, the appellant may give notice of appeal to the Board

73. (Hearing and disposal of appeals to the Board of Review)

Appeals to the Supreme Court

Appeal on a question of law to the Supreme Court

74. (1) The decision of the Board shall be final:

Provided that either the appellant or the Commissioner may make an application requiring the Board to state a case on a question of law for the opinion of the Supreme Court.

10

.

(5) Any two or more Judges of the Supreme Court shall hear and determine any question of law arising on the stated case and may in accordance with the decision of the Court upon such question confirm, reduce, increase; or annul the assessment determined by the Board, or may remit the case to the Board with the opinion of the Court thereon

20

.

(7) For the purpose of enabling the Commissioner or any other party to appeal to Her Majesty in Council against any order of the Supreme Court under sub-section (5) and for the purposes of the application of the provisions of the Appeals (Privy Council) Ordinance -

(a) an order made by the Supreme Court under sub-section (5) shall, together with any Order of that Court under sub-section (6), be deemed to be a final judgment of the Supreme Court in a civil action between the Commissioner and such other party;

30

(b) the value of the matter in dispute in such civil action shall be deemed to be five thousand rupees

IN THE PRIVY COUNCIL

ON APPEAL
FROM THE SUPREME COURT OF CEYLON

B E T W E E N

THE COMMISSIONER OF
INLAND REVENUE Appellant

- and -

A.W. DAVITH APPUHAMY Respondent

CASE FOR THE APPELLANT

T.L. WILSON & CO.,
6 Westminster Palace Gardens,
London, S.W.1.
Solicitors for the Appellant.