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1941 *Present :* **Howard C.J., Soertsz, Keuneman, de Kretser and Wijeyewardene JJ.**

THE CEYLON INVESTMENTS CO., LTD. *v.* THE COMMISSIONER OF INCOME TAX.

S. C. No. 5—Income Tax Appeal.

Income Tax—Investment Company—Assessable income—Claim to deduct management expenses—Expenses incurred in production of income—Income Tax Ordinance (Cap. 188), ss. 6 (1) (a) and (e), 9 (1) and (3).

Where the income of an Investment company is derived from dividends declared by companies in which it owns shares and from money lent out by the Company on interest,—

Held by SOERTSZ, KEUNEMAN, DE KRETSER, and WIJEYEWARDENE JJ. (HOWARD C.J. dissenting), that the management expenses of the Company are deductable in ascertaining the assessable income of the Company.

The income of the Company falls within the words "profits of a business" of section 6 (1) (*a*) of the Income Tax Ordinance.

Per HOWARD C.J.—

Where the business of a Company consists of the receipts of dividends and of interest alone or if such a business can be clearly separated from the rest of the trade or business, the Commissioner of Income Tax has the right to charge the Company under section 6 (1) (*e*) in respect of the dividends and interest received from undertakings in which its capital is invested. In such a case the management expenses are not deductable in ascertaining the assessable income of the Company.

THIS was a case stated for the opinion of the Supreme Court by the Board of Review under the Income Tax Ordinance.

The appellant is an investment company whose income is derived from dividends declared by companies in which it owns shares and interest on moneys lent out by it. The company does not carry on any trade. The question at issue is whether the company is entitled to deduct the management expenses (such as directors' fees, secretaries' and auditors' fees) in ascertaining the assessable income of the company.

H. V. Perera, K.C. (with him *E. F. N. Gratiaen*), for assessee, appellant.—The question for decision is whether the management expenses of the appellant company can be allowed to be deducted from its income for the purpose of taxation. The assessee is an investment company. Its object is to invest money in shares in other companies, and its income is derived from the dividends declared by the latter and also from interest on moneys lent out by it.

The deductions claimed by the appellant are "outgoings and expenses incurred in the production" of the profits or income within the meaning of section 9 (1) of the Income Tax Ordinance (Cap. 188). It is necessary to ascertain what the source of income is in the present case. For that

purpose one has to examine sections 5 and 6 of Cap. 188. Our case falls exclusively under section 6 (1) (*a*), and section 6 (1) (*e*) should be excluded and has no application. There is a difference between investments of a private individual and investments by a company carrying on the business of making investments. In the former case each investment is an isolated source of income. On the other hand, where a company exists for the purpose of making investments, the source of income is the business. The receipts of such a business must be taken as a whole—*National Bank of India v. Commissioner of Income Tax*[1].

That the appellant should be treated as carrying on a business is clear from a consideration of the following cases:—*The Commissioners of Inland Revenue v. The Korean Syndicate, Ltd.*[2]; *The Commissioners of Inland Revenue v. The Birmingham Theatre Royal Estate Co., Ltd.*[3]; *The Commissioners of Inland Revenue v. The Tyre Investment Trust, Ltd.*[4]; *The Commissioners of Inland Revenue v. The South Behar Railway Co., Ltd.*[5] (Lord Summer's judgment); *The Commissioners of Inland Revenue v. Dale Steamship Co.*[6]; *The Glamorgan Coal Co., Ltd. v. The Commissioners of Inland Revenue*[7]; *Butler v. The Mortgage Co. of Egypt, Ltd.*[8] See also *Sunderam's Income Tax of India (3rd ed.)*, p. 431. For meaning of the term "business", see *Smith v. Anderson*[9].

Section 6 of Cap. 188 gives an enumeration of various sources of income. Those heads are mutually exclusive. See section 47. Further, it may be observed that, in his argument in *National Bank of India v. Commissioner of Income Tax* (*supra*) the Attorney-General conceded that 6 (1) (*a*) and section 6 (1) (*e*) are mutually exclusive. In England the law is different, for sometimes the Crown is given an option to choose between different categories. The Commissioner's reliance on section 6 (1) (*e*) read in conjunction with section 9 (3) cannot be justified. On the authority of the English cases already cited the appellant is carrying on a business. The receipt of the dividends should not be separated from the rest of the business. To do so would be to take the life out of the business. Similarly the items of interest received on moneys lent are "embedded" in the business, and should not be separated off. See the cases referred to in *Halsbury's Laws of England (2nd ed.)*, *vol. 17, p. 190, para. 391.*

M. W. H. de Silva, Acting S.-G. (with him *H. H. Basnayake, C.C.*), for Income Tax Commissioner.—The English cases cited on behalf of the appellant were based on the Excess Profits Duty Act and the Corporation Profits Tax Act. The term "business" in those Acts has a much more extended meaning than in our Income Tax Ordinance. See section 39 of the *Finance Act, No. 2 of 1915* (5 & 6 *Geo. V., c. 89*) and section 53 of *Finance Act of 1920* (*10 & 11 Geo. V., c. 18*). In those Acts the holding of investments is regarded as a business and is specially provided for. This point is brought out clearly in the case of *Morning Post v. George* reported at page 230 of the journal "Taxation", vol. 26, No. 695 of January 18, 1941. Care, therefore, has to be taken to examine the actual Acts under which the English cases were decided.

[1] *(1939) 40 N. L. R. 193.*
[2] *12 T. C. 181.*
[3] *12 T. C. 580.*
[4] *12 T. C. 646.*
[5] *12 T. C. 657.*
[6] *12 T. C. 712.*
[7] *12 T. C. 1027.*
[8] *13 T. C. 803.*
[9] *(1880) 15 Ch. D. 258 at 260.*

With regard to section 6 of the arrangement in our Ordinance is not the same as in the English Acts where the schedules are more or less exclusive. The contention that the present case falls exclusively under section 6 (1) (*a*) is untenable. The company can earn profit in various ways. All the profits accruing from various sources cannot be grouped together as coming from a single source. Section 47 of our Ordinance is helpful on this point. Tax on income from the various sources mentioned in section 6 falls to be charged according to the source from which the income is derived. The fact that income from one of the sources mentioned in section 6 forms the whole or part of the receipts of a business does not alter the receipts from that source to receipts from business or trade. See *Salisbury House Estate, Ltd. v. Fry* [1]; and *The Commercial Properties, Ltd. v. The Commissioner of Income Tax, Bengal* [2]. In the present case the whole of the income should be taken into account without any deductions for management expenses—*The Commissioners of Inland Revenue v. Sneath* [3]; *Aikin v. The Trusts of C. M. Macdonald* [4]; *Bowers v. Harding* [5]; *Scottish Mortgage Co. of New Mexico v. McKelivie* [6].

It is important to note that, in England, under section 33 of the Income Tax Act, 1918, the management expenses of an investment company are specially made deductable. There is no such section in our Ordinance. On the other hand, under our section 42 (1) deductions for management expenses are possible only in the case of life insurance companies.

The dividends and interest in this case fall exclusively under section 6 (1) (*e*). Section 49 contains special provision regarding dividends. No deduction can be claimed under section 9 (1). The dividends are the result of the activities of the companies which pay them, and all outgoings and expenses incurred in the production of the profits from which the dividends were paid have been already alloyed to those companies in which the appellant company holds shares. The appellant company does nothing to "produce" the dividends. As regards the interest, no deduction can be allowed in respect of it. Section 9 (3) is explicit. See also *The Commissioner of Income Tax v. Arunachalam Chettiar* [7].

Even if the income falls under section 6 (1) (*a*), the taxing authority has the right of option to elect between section 6 (1) (*a*) and section (6) (*e*) when the two heads are equally applicable. For the law regarding Crown's option see *Scottish Mortgage Co. of New Mexico v. McKelvie (supra)*; *Smiles v. Australasian Mortgage and Agency Co., Ltd.* [8]; *The Liverpool and London and Globe Insurance Co. v. Bennett* [9]; *Butler v. The Mortgage Company of Egypt, Ltd.* [10]; *Konstam's Law of Income Tax (7th ed.), p. 113; The Commissioner of Income Tax v. Arunachalam Chettiar (supra)*.

H. V. Perera, K.C., in reply.—English cases can be relied on only so far as they are applicable and so far as they are helpful to understand general principles. The cases in respect of Crown's option depend on the peculiar

[1] *15 T. C. 266 at 281.*
[2] *3 Indian T. C. 23.*
[3] *17 T. C. 149.*
[4] *3 T. C. 306.*
[5] *3 T. C. 22.*
[6] *2 T. C. 165.*
[7] *(1935) 37 N. L. R. 145.*
[8] *2 T. C. 367.*
[9] *6 T. C. 327 at 371 and 376*
[10] *13 T. C. 803.*

structure of the English Act. The remarks of Akbar J. in *The Commissioner of Income Tax v. Arunachalam Chettiar* [1] on the point of Crown's option are only *obiter*.

In English cases it is necessary to see what the charging section is. The charging section of the Income Tax Act of 1918 (*8 & 9 Geo. V., c. 40*) refers not only to profits and income but also includes property as a subject of charge. Property would include *inter alia* investments. Regarding tax on property as distinct from tax on profits and gains see *The Commissioners of Inland Revenue v. The Scottish Central Electric Power Co.*[2]; *Salisbury House Estate, Ltd. v. Fry*[3]; *Konstam's Law of Income Tax (4th ed.), p. 119.* The only charging section in our Ordinance is section 5 under which tax is payable only on profits and income. Section 6 (1) is purely explanatory, and enacts only in section 6 (1) (*c*). Interest is not taxable unless it is profits or income.

Section 42 makes special provisions for deduction for management expenses in the case of life insurance companies not because no deductions are permissible in the case of other companies but because of the special nature of life insurance business. See *Konstam's Law of Income Tax (4th ed.), p. 137.*

Cur. adv. vult.

September 18, 1941. HOWARD C.J.—

This is an appeal by way of case stated on a point of law under section 71 of the Income Tax Ordinance from a decision of the Board of Review holding that the management expenses claimed as deductions from the income of the appellant company were rightly disallowed by the Commissioner. The decision of the Board of Review states that "the whole case turns on the construction to be placed on the words 'expenses incurred . . . . in the production of income' as used in section 9", that "on the facts it is evident that the Company's activities, so far as they are material, during the year of assessment, were limited to receiving dividends and interest and accounting for them" and that "in these circumstances we are not satisfied that the appellant has proved that it is entitled to the deduction which it claims on the ground that they were expenses incurred by the company in the production of its income". The appellant is an investment company, whose income in derived from dividends declared by companies in which it owns shares and interest on moneys let out by it. The assessor, whose assessment was confirmed by the Commissioner, in disallowing the management expenses (such as Directors', Secretaries', and Auditors' fees) drew a distinction between an investment company and a company which carried on a trade or commercial enterprise because, in the former case, no expense had to be incurred by the assessee company for the production of its income in the shape of dividends which it received from the companies or concerns in which it held shares. The Assessor further contended that whatever expenditure was necessary for the production of the income (of which the dividend was a mere distribution) had already been deducted by the company in which the shares were held, that once an investment had been made no further expenditure was necessary on the part of the

[1] *(1935) 37 N. L. R. 145.*

[2] *13 T. C. 331 at 331.*

[3] *15 T. C. 266 at 324.*

appellant for the production of its income from that investment and that section 10 (*b*) also precluded any such deduction as claimed.

On behalf of the appellant company Mr. H. V. Perera has contended that its income should have been assessed under section 6 (1) (*a*) of the Ordinance as a business. If so assessed, there would be allowable as a deduction from such income under section 9 (1) the management expenses as "all outgoings and expenses incurred by such person in the production thereof". If the appellant Company was assessed as a business, its taxable income like that of any other business should be ascertained by deducting its expenses from its receipts. Moreover the receipts must be taken as a whole. The receipt of each dividend was not to be considered as an isolated transaction and assessed as such. In this connection he invited our attention to *National Bank of India v. Commissioner of Income Tax*[1], where an attempt was made to treat as an isolated transaction for the purpose of the levy of income tax interest paid on overdrafts by a resident of Ceylon to a non-resident Bank in London as being income "arising in or derived from Ceylon". It was held that such interest cannot be said "to arise in or be derived from Ceylon". Poyser J. in his judgment also stated that one difficulty in upholding the argument of the Crown was that the Commissioner of Income Tax had assessed the Bank on the interest due on the overdrafts without any deduction for business expenses. It is interesting to note that in his argument the Attorney-General stated that, if investment is made by a bank as part of its banking business in Ceylon interest would not be taxed separately under section 6 (1) (*e*), but the profits of the business would be charged under section 6 (1) (*a*). In the case of the *National Bank of India v. Commissioner of Income Tax* (*supra*) it was, therefore, stated by Counsel for the Crown and assumed by the Court that, so far as Bank interest was concerned, the income would be ascertained as in the case of a business under section 6 (1) (*a*). In order to meet the contention of the Crown that the appellant Company should be assessed under section 6 (1) (*e*) and not as a "business" under section 6 (1) (*a*), Counsel for the appellant has referred us to numerous English authorities to establish the proposition that, although the income of the Company was derived solely from dividends declared by other companies in which it owed shares and interest on moneys lent out by it and its operations included no other trading enterprise, it was carrying on business. In *Commissioners of Inland Revenue v. The Korean Syndicate Limited*[2], it was held by the Court of Appeal that, although during the years material to the case the Syndicate's activities were confined to receiving the bank interest and royalties (its only income) distributing the amount amongst its share holders and paying the premiums on a sinking fund policy, the syndicate was carrying on the business for which it was incorporated of acquiring concessions and turning them to account and that the profits derived therefrom were liable to Excess Profits Duty. In Atkin L.J.'s judgment it is stated as follows :—

> "For I see nothing to prevent a holding company, which is a very well known method of carrying on business in these days, from carrying on business."

[1] *40 N. L. R. 193.*

[2] *12 T. C. 181.*

The following passages from Lord Sterndale M.R's judgment are also in point:—

> "An individual comes into existence for many purposes, or perhaps sometimes for none, whereas a limited Company comes into existence for some particular purpose of carrying out a transaction by getting possession of concessions and turning them to account, then that is a matter to be considered when you come to decide whether doing that is carrying on a business or not."

So also in *Commissioners of Inland Revenue v. Tyre Investment Trust Limited*[1] it was held by Rowlatt J., that the principal business of the respondent company consisted in the making of investments and that it was within the charge of Excess Profits Duty. The same principle was formulated in the *Commissioners of Inland Revenue v. The Westleigh Estates Co., Ltd., The South Behar Railway Co., Ltd., The Eccentric Club, Ltd.*[2]. At pp. 688 and 689 Pollock M.R. stated as follows:—

> "Its business may be quiescent, and to a large extent, a matter of routine. Its receipts may be derived, if not wholly, at least almost entirely from the annual payments made to it by the Secretary of State; but it remains a Company alive, and still requiring, if only in smaller details, the direction of its directors and the duties carried out by its secretary. It is still concerned in the business of disposing of and dividing the profits which it has become entitled to by reason of its greater activity in the past, and that activity, as well as possibly others, may be awakened and quickened in the future. For these reasons I am of opinion that the appeal must be allowed, with costs here and below."

This decision of the Court of Appeal was affirmed by the House of Lords when Lord Sumner at p. 711 of the report stated as follows:—

> "It is obvious that the Company's objects have by no means been accomplished. It is obvious, too, that during its present period of dormant life it has very little to do. I do not attach much importance to the domestic operations of declaring and paying dividends, remunerating directors and presenting reports, but the operation of receiving and thus discharging the annuity payments goes on continuously, and however simple, it is not a mere passive acquiescence. It is the transaction of business between debtor and creditor resulting periodically in the discharge of a debt. The present is not the case of a company existing to do one act only and once for all. Not only did the company make the agreement of 1906, but it plays its recurring part in every payment and receipt of gains, and there is here, therefore that 'repetition of acts', which Lord Justice Brett says (*15 Ch. D. at p. 277*) is implied in 'carrying on business'."

The Acting Solicitor-General has contended that the interpretation given by the English Courts in the cases I have cited as to what activities constituted carrying on "business" turned on the special meaning of this term in the Acts imposing duties on excess profits and can have no application to the term as employed in the Ceylon Income Tax Ordinance.

[1] *12 T. C. 646.*

[2] *12 T. C. 657.*

I am unable to accept this contention. The Finance Act, 1915 (5 & 6 *Geo. V, c. 89*), does not contain any special definition of business. The language used by the Judges in the cases cited as to the meaning of the term "business" is of general application. Moreover their interpretation is consistent with what was laid down by Jessel M.R., as to the meaning of the term in *Smith v. Anderson* [1], a case that did not involve the imposition of taxation. In this connection I would also refer to the judgment of the Judges of the House of Lords in *The Liverpool and London and Globe Insurance Co. v. Bennett* [2]. In that case the argument that investments of reserve funds were not part of the business of the company was rejected.

Applying the principles laid down in the English cases which, I have cited there can be no doubt that the appellant company, though functioning as an Investment Company only for which purpose it came into existence, has not accomplished its purpose and was carrying on business in the way a holding company does carry on business. I am, therefore, of opinion that the income derived by the appellant company from dividends and interest fall within the words "profits from any business" under section 6 (1) (*a*).

The further question then arises as to whether the management expenses are deductable under section 9 (1). Can it be said that they are outgoings and expenses incurred "in the production of" the profits? The Acting Solicitor-General has embraced the argument of the Assessor and contended that the management expenses are not incurred in the production of the income. Section 6 (1) enumerates various sources of "profits and income" or "profits" or "income". Section 9 (1) also employs the word "source" which must be regarded as having reference to section 6 (1). If "source" has reference to a trade or business, as specified in section 6 (1) (*a*), I am of opinion that the management expenses of the appellant company are deductable as incurred in "the production of the profits". It has been argued as part of the case for the Commissioner of Income Tax that once an investment had been made no further expenditure was necessary on the part of the appellant company for the production of its income from that investment. Moreover the Chairman of the Board of Review in his judgment states that on the facts it is evident that the company's activities, so far as they are material, during the year of assessment, were limited to receiving dividends and interest and accounting for them. I am of opinion that so far as this aspect of the case is concerned the Commissioner and the Board have regarded the matter from the wrong angle. In his judgment in *The Naval Colliery Co., Ltd., The Glamorgan Coal Co., Ltd. v. The Commissioners of Inland Revenue* [3] Rowlatt J. stated as follows :—

> "Now, one starts, of course, with the principle that has often been laid down in many other cases—it was cited from *Whimster's case* [4], a Scotch case—that the profits for Income Tax purposes are the receipts of the business less the expenditure incurred in earning those receipts. It is quite true and accurate to say, as Mr. Maugham says, that receipts and expenditure require a little explanation. Receipts include debts due and they also include, at any rate in the

[1] *15 Ch. D. at p. 258.*
[2] *6 T. C. 327*
[3] *12 T. C. at p. 1027.*
[4] *12 T. C. 813.*

case of a trader, goods in stock. Expenditure includes debts payable; and expenditure incurred in repairs, the running expenses of a business and so on, cannot be allocated directly to corresponding items of receipts, and it cannot be restricted in its allowance in some way corresponding, or in an endeavour to make it correspond, to the actual receipts during the particular year. If running repairs are made, if lubricants are bought, of course no inquiry is instituted as to whether those repairs were partly owing to wear and tear that earned profits in the preceding year or whether they will not help to make profits in the following year and so on. The way it is looked at, and must be looked at, is this, that that sort of expenditure is expenditure incurred on the running of the business as a whole in each year, and the income is the income of the business as a whole for the year, without trying to trace items of expenditure as earning particular items of profit."

It is, therefore, wrong to decide the question as to whether a particular item of expenditure is deductable by endeavouring to make it correspond with a receipt item during a particular year. The item is deductable if it is that sort of expenditure which is incurred on the running of the business as a whole in each year. Looked at from this angle there can be no doubt that the management expenses of the appellant company were deductable.

The Acting Solicitor-General has raised the further contention that, even if the appellant company was carrying on business and as such entitled to have the management expenses deducted from its profits, the question is immaterial as the income derived by the appellant company from dividends and interest falls within the term "dividends, interest or discounts" as employed in paragraph (*e*) of section 6 (1). If the income of the appellant company falls within the ambit of both paragraphs, he maintains that the Crown could elect under which paragraph it would make its assessment. The Crown having elected to assess under paragraph (*e*) no deduction for management expenses as claimed is permissible under the Ordinance. In connection with the Crown's right of election the Acting Solicitor-General has cited the case of *Scottish Mortgage Co. of New Mexico v. McKelvie*[1] where the money of the company was borrowed in Scotland and lent at a greater rate of interest in the United States of America. The question for decision was whether the duty had been properly charged as falling within the fourth case of Schedule D of the Income Tax Act as interest or whether it should have been charged according to the rules applying to the first case under Schedule D as profits from trade. In his judgement the Lord President stated as follows:—

"Now, My Lords, this is undoubtedly a trading Company, and I do not doubt that the duty might have been charged in this case as under the first case in Schedule D; but that is not the question. The question is whether it may be lawfully charged under the fourth case. One can quite understand that in particular circumstances the duty may be chargeable either under the one or the other. The income in respect of which the duty is to be charged may fall under more than one description in the Statute, and in that case it would of course

[1] *2 T. C. 165.*

be in the option of the Commissioners of Inland Revenue to take the case that was most favourable to themselves. Now it appears to me that although this might have been charged as a duty upon the balance of profits and gains under the first case, it is equally chargeable as the interest accruing upon foreign securities under the fourth case."

In *Smiles v. Australian Mortgage and Agency Company, Ltd.*[1] the company carried on a wool-broker's business abroad and, in the course of the wool broking business and to facilitate it, made loans to customers varying in amount, sometimes covered by second mortgages on real estate. It was held that the interest on these loans could not be taxed as the interest on foreign securities, but must be brought into the receipts and disbursements of the business. In his judgment the Lord President stated as follows :—

"The account between the Company and its customers is just of the nature of a current account as between banker and customer and not at all in the nature of investments of money. Also that it is proper trading and nothing else and not investments of money on securities."

In *Liverpool and London and Globe Insurance Co. v. Bennett*[2] Lord Shaw of Dunfermline stated as follows :—

"My Lords, it is not necessary to decide whether that case applies or not. The assessment had been laid on, not in respect of it, but has been laid on in respect of the First Case in Schedule D, which is applicable to the balance of profit of trade. The argument as to the Fourth Case, therefore, drops out, because it is well settled that if a sufficient warrant be found in the Statute for taxation under alternative heads the alternative lies with the taxing authority. They have selected case I. It appears to me that this selection is not only justified in law, but is founded upon the soundest and most elementary principles of business."

In both of these cases the option vested in the Crown was to elect as between the different cases of Schedule D. In *Fry v. Salisbury House Estate, Ltd.*[3] the Crown sought to extend this principle so that it gave the right of election as between Schedules. The House of Lords held that rents were profits arising from the ownership of land in respect of which the assessment under Schedule A was exhaustive, and that they therefore could not be included in the assessment under Schedule D as trade receipts of the company. In his judgment, however, Lord Dunedin seemed to think that there might be a right of election as between Schedule C and Case III. of Schedule D inasmuch as such an option would not in any way disturb the scheme of the Act. The operations from an income tax point of view of a company carrying on a similar business to that of the appellant company were also considered in the case of *Butler v. The Mortgage Company of Egypt, Ltd.*[4]. In this case the business of the company consisted in lending the money borrowed from its shareholders upon mortgage in Egypt and the interest it obtained from those

[1] *2 T. C. 367.*
[2] *6 T. C. 376.*
[3] *(1930) A. C. 432.*
[4] *13 T. C. 803.*

mortgages formed its income, with allowances for expenses and for bad debts before it could pay a dividend or find the profits. The Crown assessed the company under case IV., namely, on the foreign securities represented by the Egyptian mortgages. The company contended that the tax ought not to be charged under that case, but under case V. upon their business in Egypt, a foreign country. As in the case of the Mexican Company the interest received and investments made were made incidentally to their trade of borrowing the money and lending it abroad, they were embedded in the business of a company whose business it was to conduct that sort of transaction. In these circumstances it was held by Rowlatt J. whose decision was affirmed by the Court of Appeal, that the income was income arising from foreign securities and assessable under case IV. of Schedule D. In his judgement Rowlatt J. in drawing a distinction between a case like the Mexican case and the Australasian case stated as follows :—

> "It is not that you can say one is an investment company and the other is a trading company and there is a different rule for investment companies and trading companies in this respect that when you have a trading company you can transfer from case IV. to case I., but when you have an investment company you cannot : I do not think that is the distinction. The true ground is put in *The Liverpool and London and Globe Insurance Company* and in the Australasian case : 'when you have words in a case which apply to the facts under discussion the tax applies under that case and the subject cannot escape from it'. In the Australasian case the distinction taken was that when you have interest earned in this sort of way in the course of a business in which loans of this kind have to be made for the purposes of a business, you do not get the interest emerging as taxable under any case at all till you get to business—that is the point—as in the ordinary case of a banker in this country. He receives no end of interest which is taxable matter under case III., but it is not taxed as interest because it is merely incidental ; it is only part of the business to make this interest, not as interest, but as the income of the business. In the case of the Mexican Company the interest they received and the investments they made were made incidentally to their trade of borrowing the money at interest in England and lending it in America. It is exactly the same here. They are embedded in the trade. How does the subject get out of the charge imposed by case IV. ? I cannot see any way of getting out, because if you are once within case IV. you cannot get out of it."

There is no doubt that the business of the appellant company approximated to that of the Mexican and Egyptian Companies to which I have referred rather than to that of the undertaking of a banker where loans have to be made for the purposes of the business. In these circumstances if the "sources" of income enumerated in section 6 (1) of the Income Tax Ordinance are to be treated as cases under Schedule D of the Income Tax Act, it would seem that the Crown can elect whether it will charge under paragraph (*a*) or (*e*). That the Crown has such an election was the view expressed by Akbar J., in *The Commissioner of*

Income Tax v. R. M. A. R. A. R. R. M. Arunachalam Chettiar.[1] This case was concerned with the business of a money-lender and in his judgment Akbar J. stated as follows :—

> " . . . . It makes no difference if the assessee carried on solely the business of lending money, for in that case the Crown has the choice of assessing him either under head 6 (1) (*a*) or 6 (1) (*e*)."

It was not necessary for the decision of the case for the learned Judge to have decided this point. His view is, therefore, merely *obiter*.

I have now to consider whether there is anything in the scheme formulated in the Income Tax Ordinance to indicate that the principle laid down by the cases I have cited with regard to the interpretation of the English Income Tax Act is inapplicable. The interpretation section of the Ordinance defines " profits " or " income " to mean the net profits or income from any source for any period calculated in accordance with the provision of the Ordinance. Section 5 (1) of the Ordinance imposes income tax in respect of the profits and income of every person for the year preceding the year of assessment—

(*a*) wherever arising, in the case of a person resident in Ceylon, and

(*b*) arising in or derived from Ceylon, in the case of every other person.

Enumerated in paragraphs (*a*) to (*h*) of section 6 (1) are the various sources of " Profits and income " or " profits " or " income ". In section 1 of the Income Tax Act, 1918 (*8 & 9 Geo. V. c. 4*), it is provided that income tax shall be charged for a particular year in respect of all property, profits or gains respectively described or comprised in the Schedules marked A, B, C, D and E contained in the First Schedule to the Act and in accordance with the Rules respectively applicable to the Schedules. Whereas the charge in the English Act is on " property, profits or gains or comprised as described in the schedule", in Ceylon it is charged by virtue of section 5 (1) and the interpretation section on net profits or income from any source. For the enumeration of sources we must turn to section 6 (1). Can it be said that these sources like the Schedules in England are mutually exclusive ? The wording of sources (*a*), (*b*) and (*c*) shows that these sources are mutually exclusive. (*d*) excludes (*a*), (*b*) and (*c*), and (*h*) excludes all previous sources. But there are no words in (*e*) to show that this source does not apply to dividends, interest or discounts arising from a trade or business. 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.

[1] *37 N. O. R. 145.*

The only remaining question for consideration is whether there are any provisions permitting the deduction of management expenses in arriving at the net income of a Company when such income is derived from source (*e*). This involves the interpretations of sections 9 and 10. Subject to sub-sections (2) and (3), section 9 (1) permits the deduction of all outgoings and expenses incurred by a person in the production of income and applies to profits and income from any source and would therefore *prima facie* apply to all the sources in section 6 (1) (*a*) to (*h*). Section 9 (3) provides that income from "interest" shall be the full amount without any deductions for outgoings or expenses. Section 10 (*b*) provides that no deduction shall be allowed for any disbursements or expenses not being money expended for the purpose of producing the income. Can it be said that the management expenses were disbursements expended for producing the dividends received by the appellant Company from investments in other Companies? I do not think it can be. In England by virtue of section 33 of the Income Tax Act, 1918, the management expenses of any Company whose business consists mainly in the making of investments are deductable. No such provision exists in the Ceylon Ordinance and having regard to its absence I am unable to say that management expenses can be deducted in order to ascertain the assessable income.

SOERTSZ J.—

I have had the advantage of reading the judgments of My Lord the Chief Justice and of my brother Keuneman, and I respectfully agree with them both, that the appellant company though functioning as an investment company only—and that is the purpose for which it came into existence—still continue in pursuit of that purpose to carry on business in the way a holding company does carry on business. I also agree that everything that accrued to the company, in the course of its business, by way of pecuniary gain—whatever the form of that gain, whether dividends, interest, discounts or some other thing—falls within the words "profits from any business". I am quite unable to see my way to endorse the view expressed by the Taxing Authorities, and by the Board of Review, and advanced to us by the Acting Solicitor-General, that whatever expenditure was necessary for the production of the income of this company had already been deducted by the company in which the shares were held; that once an investment had been made, no further expenditure was necessary on the part of the appellant company for the production of its income from that investment, and that section 10 (*b*) precluded any such deduction as is here claimed on account of Directors' fees, Secretary's remuneration, &c. As pointed out by Pollock M.R. in the case cited by the Chief Justice from *12 Tax Cases 657*, the business of a company

> "may be quiescent, and to a large extent, a matter of routine. Its receipts may be derived if not wholly, at least almost entirely from the annual payments made to it by the Secretary of State; but it remains a company still alive, and still requiring, if only in smaller details, the directions of its directors and the duties carried out by its Secretary. It is still concerned with the business of disposing of and dividing

profits which it has become entitled to by reason of its greater activity in the past, and that activity as well as possibly others may well be awakened and quickened in the future."

In regard to the next contention of the Acting Solicitor-General that even if the appellant Company was carrying on a business and for that reason, came under section 6 (1) (*a*) and was entitled to claim deduction on account of the management expenses of that business, under section 9 (1), yet as the gain derived by it from "dividends and interest" falls within the words "dividends, interest or discounts" of section 6 (1) (*e*) as well, the Crown is entitled to elect under which of these heads 6 (1) (*a*) or 6 (1) (*e*) it will make its assessment, I greatly regret that I cannot assent to the view taken by My Lord the Chief Justice in upholding that contention. On that point, while I agree with my brother Keuneman that the Crown has no such option, and that "it was the intention of the Ordinance to regard dividends, interest or discounts as a separate source". I venture to differ when he says that

> "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, interests or discounts must be applied*",

in so far as that statement, as I understand it, implies that section 9 (3) will uniformly apply if the "interest" part of the gains of a *business* is separate or separable from the "dividends" part of it.

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).

The word "profits" and the word "income" are, clearly, not synonymous, and an examination of the wording of the Ordinance shows that they have not been used interchangeably or indiscriminately but that the Legislature has employed them with great deliberation. The Ordinance speaks of "*profits* and *income*", indicating thereby that the taxable subject-matter may consist, in one case, of both *profits* and *income* as understood in the Ordinance; in a second case, of *profits* alone; and in a third case of *income* alone.

In section 6, the Legislature has chosen to apply the word *profits* to the proceeds of "any trade, business, profession or vocation" (*a*), or of "any employment" (*b*). On the other hand, to describe the advantage contemplated in (c), when that advantage is not connected with trade, business, &c., and to describe the advantage contemplated in (*d*) it uses

the word *income* " in each case ". In the case (*e*), (*f*) and (*g*) they are not specified either as " profits " or as " income " for the reason—I infer—that it would depend on the circumstances of a particular case whether the things mentioned in those sub-sections are to be treated as *profits* or as *income*. If they appertain to (*a*) and (*b*) they are *profits* ; if they do not, they constitute *income*. In the residium—catching clause (*h*)—yields from any other source are regarded as " income " with the one exception of windfalls or accruals of " a casual and non-recurring nature " to which the word *profits* is applied. Section 6 (2) (*a*) enumerates many classes of " profits from employment " without claiming to exhaust them. Section 7 (1) (*a*) to (*d*) deal with certain kinds of income. Section 7 (1) (*e*) conformably with the description of the advantage contemplated under 6 (1) (*c*) and (*d*) as *income*, puts the annual value of places of worship as *income* entitled to exemption, and finally 7 (1) (*n*) deals with the *profits* and *income* of a Co-operative Society.

The point I seek to emphasize is that two words " profits " and " income " are used with great discrimination, and that effect must be given to that fact.

Chapter III. of the Ordinance deals with the mode of " Ascertainment of *profits* or *income* ", and section 9 (1) provides that both, in regard to *profits* and *income*, certain deductions shall be made " *subject to the provisions of sub-section (2) and (3)* ". Now in sub-section (2), it is stated that " in ascertaining the *profits* or *income* arising from the rent or annual value of land and improvements thereon, no deduction shall be made for outgoings and expenses except those authorised in section 6 ". As I have already pointed out the advantage accruing from annual value of land under (*c*) and (*d*) of section (6) is *income* if the land is not occupied for the purpose of a trade, business, profession or vocation. If it is so occupied the resulting advantage is regarded as part of the profits of the trade, business, &c., and falls under 6 (1) (*a*). In sub-section (2) of section 9 the Legislature states clearly that whether the advantage derived from the rent or annual value falls to be described as *profits* or as *income*, the only permissible deductions are those stated in section 6. But in sub-section (3) of section 9, the disallowance of deduction for outgoings or expenses is restricted to *income* from interest. To my mind, this restriction is most significant. As held by My Lord the Chief Justice, the *dividends and interests* derived by the appellant company fall within the words " *profits of any business* ". As I have already submitted, dividends and interests may well be the *income* of an individual from simple investments, and sub-section (3) is careful to enforce a disallowance in regard to interests that is part of *income* but not in regard to interest that is part of *profits*.

For these reasons, I agree to make the order proposed by my brother Keuneman.

KEUNEMAN J.—

This appeal came before the Appeal Court on a case stated by the Board of Review. It was originally heard by His Lordship the Chief Justice and myself, and was referred to a Bench of five Judges.

The facts are as follows :—

The appellant is an Investment Company, whose income is derived from dividends declared by companies in which it owns shares, and interest on moneys lent out by it. The company does not carry on any trade. The point at issue is the disallowance by the Assessor of a sum of Rs. 1,270 which was claimed as a deduction from the income of the company, being the amount of management expenses (such as Directors' fees, Secretaries' and Auditors' fees, &c., incurred during the material period). The amount of tax in dispute, in consequence of the disallowance of this deduction, is Rs. 153.96.

This appellant then appealed to the Commissioner of Income Tax, who confirmed the assessment of the Assessor. The Commissioner in his order depended on section 9 (1) and 10 (*b*) of the Income Tax Ordinance (Chapter 188) and held that this was not an expense incurred in the production of the income. He further held that the income of the appellant company was from dividends and interest and not from a trade or business. He pointed out that in England section 33 of the Finance Act, 1918, gives by way of relief a deduction for management expenses in the case of life insurance companies and companies whose business consists mainly in the making of investments, and that under section 42 of our Ordinance management expenses are allowed in the case of insurance companies, but there is no similar provision in the case of companies holding investments.

An appeal was then taken to the Board of Review, but was dismissed, on the ground that the expenses in question were not incurred in the production of the income.

I think it will be convenient at this stage to set out the principal sections which arise for consideration in this appeal.

Under section 3 the interpretation clause, "'Profits' or 'Income' means the *net* profits or income from any source for any period calculated in accordance with the provisions of this Ordinance."

We accordingly start our inquiry bearing in mind two points, viz. :— (1) that the profits or income are always *net* profits or income, and (2) that what are *net* profits or income are to be calculated in accordance with the provisions of the Ordinance.

Under section 5 (1), which is the charging section, "Income Tax shall . . . . be charged at the rate or rates specified . . . . in respect of the profits and income of every person for the year preceding the year of assessment—

(*a*) wherever arising, in the case of a person resident in Ceylon, and

(*b*) arising in or derived from Ceylon, in the case of every other person . . . . ".

By section 5 (2) "without in any way limiting the meaning of the term, 'profits and income arising in or derived from Ceylon' *includes* all profits and income derived from services rendered in Ceylon, or from property in Ceylon or from business transacted in Ceylon whether directly or through an agent."

The effect of section 5 (1) is to charge the tax on "profits and income", while section 5 (2) enumerates certain classes of profits and income which properly come under the term "profits and income *arising in or derived from Ceylon*", but is careful not to limit the meaning of that term to the matters so enumerated.

Section 6 (1) says "For the purposes of this Ordinance '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;

(*e*) dividends, interests or discounts."

I quote only those portions of the section as are immediately material. But I may add, that in view of section 6 (1) (*h*), viz.:— "income from any other source whatsoever not including profits of a casual and non-recurring nature", it seems clear that the object of section 6 (1) is to classify the term "profits and income" under certain defined "sources". I think that the term "from any source" in section 3 already cited, refers definitely to the classification under section 6 (1). Further the words "from and source" in section 9 (1) and section 10 to be cited later have reference to the same classification. It is further clear from section 47 that section 6 (1) does divide up profits and income under "sources".

Chapter 3, consisting of section 9 and 10, relates to the ascertainment of profits and income. The immediately relevant portion in this case are section 9 (1) "Subject to the provisions of sub-sections (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 . . . . .".

Section 9 (2) is not immediately relevant, but section 9 (3) says "Income arising from interest shall be the full amount of interest falling due whether paid or not, *without any deduction for outgoings or expenses* . . . . .".

Section 10 says: "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."

In my opinion Chapter 3 provides the principal means of ascertaining the *net* income and profits of any person. It applies to all the "sources" of income set out in section 6 (1), but places "interest" on a different footing. I am not taking into account for the moment the fact that section 6 (2) does also provide for the ascertainment of *net* income in the case of the net annual value of land, and that there are special cases provided for under Chapter 8, under which reference will be made later to section 42.

The main points which were argued before us were as follows:—

(1) Mr. H. V. Perera argued that profits and income in this case came exclusively under section 6 (1) (*a*) of our Ordinance, as being profits and income of business, and that the management expenses incidental to the business must be deducted in order to arrive at the net profits and income of the business. The

Acting Solicitor-General argued that the profits and income came exclusively under the heading "dividends, interests and discounts" in section 6 (1) (*e*), and could not be regarded as the profits and income of a business. Alternatively the Acting Solicitor-General argued that the profits and income in this case came both under section 6 (1) (*a*) and under section 6 (1) (*e*), and that the Crown had an option as to sub-section under which the tax could be charged.

(2) Mr. H. V. Perera argued that the management expenses were expenses incurred in the production of the income. This was disputed by the Acting Solicitor-General.

As regards the first matter argued, a number of cases were cited to us. In the case of *The Commissioner of Inland Revenue v. The Korean Syndicate, Ltd.*[1], a syndicate was registered in 1905 as a company for the purpose, *inter alia,* of acquiring and working concessions and turning them to account, and of investing and dealing with any moneys not immediately required. In 1905 the syndicate acquired a right to a concession in Korea, but in 1908 it assigned its rights to a development company under an agreement. During the years material to the case, the syndicate activities were confined to receiving the bank interest and royalties, its only income, distributing the amount among its shareholders, and paying premiums on a sinking fund policy. It was held, that the syndicate was carrying on the business for which it was incorporated of acquiring concessions and turning them into account, and that the profits derived therefrom were liable to Excess Profits Duty.

In arriving at this result, Lord Sterndale M.R. said : "It may very well be that that particular thing by itself (viz., having an agent in Korea) would not be carrying on business ; but if you couple that with what they were doing under the Memorandum and Articles, and under the agreement of March 25, 1908, then it seems to me that the only conclusion to arrive at is that this syndicate was carrying on a business of acquiring concessions and turning them into account".

As regards the particular considerations which apply to a company, as distinct from an individual, he said, "An individual comes into existence for many purposes, or perhaps sometimes for none, whereas a limited company comes into existence for some particular purpose, and if it comes into existence for the particular purpose of carrying out a transaction by getting possession of concessions and turning them to account, then that is a matter to be considered when you come to decide whether doing that is carrying on a business or not".

The remarks of Atkin L.J. also are in point, "I myself have no difficulty at all in coming to the conclusion that this company is in fact carrying on business, and it carried on a business of receiving the profits from the concession, in which it still retains an interest. It is true that it may be called, if you please, a passive carrying on of business as opposed to an active carrying on of business . . . . . Personally, if any emphasis is attached to the word 'active', I think it would narrow the meaning of

[1] *12 Reports of Tax Cases 181.*

the word ; for I see nothing to prevent a holding company, which is a very well known method of carrying on business in these days, from carrying on business ".

No doubt this was a decision relating to Excess Profits Duty, but I think the language employed in this case has general application.

Again in *The Commissioners of Inland Revenue v. The Tyre Investment Trust, Ltd.*[1], Rowlatt J. said : " It is contended by the respondent company that it exercised no control over the companies in which it held shares other than that of a shareholder. . . . . It is perfectly clear that the Act regards a company that does business in the making of investments as carrying on business . . . . I think quite clearly . . . . . this company is a company whose principal business is making investments ".

Further in *The Commissioners of Inland Revenue v. The South Behar Railway Co.*[2], decided in the House of Lords, Viscount Cave L.C. said : " It is true the company carries on no trade or manufacture, and that its principal and only function at the present moment is to receive and distribute the fruits of its undertaking but that is a part, and a material part of the purpose for which it came into existence. It was not intended to be a trading but a financial company ; . . . . The company can no longer be called upon to fulfil its first purpose, namely, to make advances for the construction of the line, because all the necessary funds have already been advanced ; but it is still fulfilling its second purpose, which was to receive an income for its shareholders . . . . and to distribute it among them . . . . I think, therefore, that the company still carries on a business or similar undertaking within the meaning of the section 52 of the Finance Act, 1920 ".

The words of Lord Sumner are also of interest : " It is obvious that the company's objects have by no means been accomplished. It is obvious, too, that during its present period of dormant life it has very little to do . . . . . But the operation of receiving and thus discharging the annuity payments goes on continuously, and however simple it is not a mere passive acquiescence. It is the transaction of business between debtor and creditor resulting periodically in the discharge of a debt . . . . The company . . . . plays its recurring part in every payment and receipt of gains, and there is here, therefore, that ' repetition of acts ' which Lord Brett says is implied in ' carrying on business ' ".

With regard to the appellant company, it is clear that it is at present functioning as an investment company, and obtains its income from dividends and interest alone. It had come into existence for this particular purpose as well as others, but it appears that for some time it has not varied its investments. But it is manifest that its objects have not been accomplished and although at present it carries on a " passive " or " dormant " life, it has not ceased to carry on business. The operation of receiving and discharging the debts due to it is regularly repeated. In fact it carries on business in the way that a holding company carries on business.

It has however been contended for the Commissioner that the interpretation of the word " business " in these cases has particular relation to the

[1] *12 Reports of Tax Cases 646.*

[2] *12 Reports of Tax Cases 657*

meaning of that word in its special context. I do not think this is correct. The language which has been used is of general application. But in view of this argument, I think it is only necessary to quote the case of *The Liverpool and London and Globe Insurance Company v. Bennett*[1], where it was held by the House of Lords under the Income Tax Act, 1842, that interest, earned on investments abroad by an English company carrying on insurance business in England and abroad and not remitted to England, forms part of the "profits and gains" of the company assessable under Case 1, Schedule D. In this connection Lord Shaw said: "There can be no doubt whatsoever that these sums . . . . were in every sense of the term a business investment . . . . No accountant, auditor or actuary could exclude the interest arising from such investments from the category of the earnings and profits of the company". His Lordship held that the company did not carry out separate business and that the matter of the investments of the company's funds was not separate from the business of fire and life insurance.

In the same case Lord Loreburn said: "The only question here is whether the interest and dividends before us are profits or gains of this company's trade, manufacture, adventure or concern in the nature of trade within the meaning of the first case. I think they are, ... whatever may have been the source from which the invested moneys were originally derived, and whether the investments were compulsory or not. They are, to use Lord Justice Buckley's apt expression the 'fruit derived from a fund employed and risked' in a business coming within the statutory description".

No doubt this case went to the extent of holding that the investments or reserve funds were part of the trade or concern in the nature of trade of fire and life insurance, but I think it is inherent in the decision, that the income from the investments was income from business. In fact, Lord Mersey rejected the argument that these investments formed no part of the "business" of the company. I accordingly hold in the present case that the income derived by the appellant company from dividends and interest fall within the words "profits from any business" under section 6 (1) (*a*).

At the same time they clearly fall within the terms "dividends, interest or discounts" under section 6 (1) (*e*).

A large number of cases have been cited to us to show that the Crown has an option to charge the tax in England on any of the cases in Schedule D, which may be chosen by the Crown, although another of the cases may also be applicable. It is argued by the Acting Solicitor-General that the Commissioner in Ceylon also has an option to choose between the various "sources" under section 6 (1). This is by no means a simple question, and it is still further complicated by the decision in England of *Salisbury House Estate, Ltd. v. Fry*[2], where, as I understand the matter, the option was held not to apply as between schedules, but only as between cases.

For example Lord Dunedin says: "It is very obvious to suggest that if the Crown can opt as between cases why should it not opt as between schedules . . . . But I think the answer is that as option between

[1] *6 Reports of Tax Cases 327.*

[2] *15 Reports of Tax Cases 266.*

cases does not in any way disturb the general scheme of the Act: an option between schedules would. I think on a general survey of the history and policy of the Income Tax Acts one finds the great distinction that there is between Schedules A and B on the one hand and the other three schedules on the other".

Lord Atkin said: "Nothing could be clearer to indicate that the schedules are mutually exclusive; that the specific income must be assessed under the specific schedule; and that D is a residual schedule".

Lord Tomlin held: "As between Schedule A and other schedules the revenue authority has no option to select the schedule to be applied".

All their Lordships disagreed with the case of *Rosyth Building and Estate Company v. Inland Revenues*[1], where a contrary opinion was expressed, with the exception of Lord Warrington who expressed no opinion on that point.

If we examine section 6 (1) of our Ordinance we see that source (*a*) deals with the profits from any trade, business, profession or vocation. Source (b) deals with a very distinct matter, viz., the profits from any employment. Source (*c*) deals with the net annual value of land occupied by or on behalf of the owner, in so far as it is not occupied for the purpose of a trade, business, profession or vocation. There is a clear differentiation between source (*c*) and source (*a*) and I think the language shows that it is distinct from source (*b*) also. Source (*d*) deals with the net annual value of land used rent-free by an occupier, &c., in so far as it is not included in sources (*a*), (*b*) and (c). So far I think those sources are mutually exclusive.

The difficulty arises with regards to sources (*e*), (*f*) and (*g*). In these cases there are no words employed to show that the earlier sources are excluded. For example take source (*e*), viz., "dividends, interest or discounts". There are no words to show that this source does not apply to dividends, interest or discounts arising from a trade or business. But "dividends, interest or discounts" are classified as a separate source.

Source (*h*) is a residual source, naturally excluding all the previous sources (*a*) to (*g*).

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 option arises.

In my opinion section 47 lends support to this view. Section 47 applies the provisions expressly relating to any particular source under section 6 (*f*) to that source and to none other.

I think this opinion is further supported to some extent when we examine Chapter 8, which deals with special cases. I do not think that

[1] *8 Reports of Tax Cases 11.*

where the provisions relating to special cases apply it is open to the Crown or the assessee to seek some other form of assessment. I think I may take as an example section 42 which has been much discussed in this case.

The profits of a company from life insurance are fixed as the investment income of the life insurance fund less the management expenses attributable to that business. This is a highly specialized form of assessment, and must be applied in all cases. Specific provisions are also laid down for assessing the profits of non-resident companies from the business of insurance, other than life insurance.

It is no doubt true that the divisions into "sources" under section 6 (1) does not appear to be scientific and it is difficult to see on what grounds the division is made. But we must take the Ordinance as we find it.

I am therefore of opinion in this case that the provisions, if any, applicable to "dividends, interest or discounts" have to be applied in estimating the net profits and income of this company.

This brings me to the second matter which was discussed before us. The discussion turned mainly on the interpretation of sections (9) and (10).

Section 9 (1) deals with the case of deductions to be made in ascertaining nett profits and income. Subject to sub-section (2) and (3), section 9 (1) applies to profits and income from *any* source, and would therefore prima facie apply to all the sources in section 6 (1) (*a*) to (*h*). Sub-section (2) restricts the deductions in respect of rent or annual value of land to those authorised in section 6, but we are not here concerned with these matters. Sub-section (3) provides for the assessment of income arising from "interest", and provides that it should be the full amount of the interest (*a*) whether paid or not and (*b*) without any deductions for outgoings or expenses. As far as we are concerned in this case, "interest" alone stands on a different footing, but subject to this, "all outgoings and expenses incurred . . . . in the production" of the profits or income must be deducted.

The argument of the Acting Solicitor-General on this point is that, as far as the appellant company is concerned, nothing has been done by it to "produce" the income or profits, and that all the activity which went to produce, say, the dividends, was on the part of those companies, in which the appellant company held shares.

I think the language used in cases I have cited earlier throws some light upon this matter. It is clear that this is not a trading but a financial company, and its business is to make investments. No doubt if the investments turn unsatisfactory, they would be varied, but where the company is satisfied with the investments these would be continued and not altered. The business of the company, to use Lord Justice Buckley's expression, was to "employ and risk" its funds, and thus obtain "fruits". In the earlier stage where the funds were being employed and risked, and when the discretion of the company to make its investments was in active operation, I think there can be no question that this company was "producing" the profits or income. And the mere fact that the funds available have been fully utilized does not change the nature of the business. There can be no question that continued vigilance is needed to see that the funds already employed and risked are giving a satisfactory return. If the returns are regarded as satisfactory, the company will

play a merely "passive" part, but that does not alter the fact that the company is still employing and risking its funds in order to produce fruits.

In this connection I refer particularly to the *South Behar Railway Co., Ltd.* case, and *The Liverpool and London and Globe Insurance Co. v. Bennett case* (*vide* supra).

I think the meaning attached by the Acting Solicitor-General to the word "production" is too narrow. I reject the argument, and hold that the management expenses claimed in this case have been incurred in the production of the income, and are necessary and reasonable expenses. I think this argument applies wherever any person carries on a business of this nature, but it is all the more applicable in the case of a company which comes into being for this object, and can only carry out its functions by the employment of directors, secretaries, &c.

I come to the conclusion, therefore that the expenses in question can be deducted at any rate as far as they relate to the dividends which the company obtains. 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.*[1]. 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 of interest are assessable as such. The ordinary rule under section 9 (1) therefore applies, and the deductions claimed can be allowed in their entirety.

I may now deal with certain other arguments which were advanced in this appeal. The Acting Solicitor-General pointed to the fact that, under section 42 (1), in the case of a company doing the business of life insurance management expenses are expressly required to be deducted, and argued that by implication management expenses are not deductable in other cases. I do not think this argument can be sustained. I have already pointed out that in this section a highly specialized form of assessment is provided, viz., assessment based not on what would ordinarily be regarded as the profits of the company, but on the investment income of the Life Insurance Fund. The section further says that a deduction must be made of the management expenses of the business. As the "profits" of this kind of company were being defined, if no reference was made to deductions, the presumption would I think have been that no deductions were allowed in this particular instance. It is also possible that in the section it was being made clear that it was the management expenses of the business, and not merely those relating to the investment income which were to be deducted.

[1] *13 Reports of Tax Cases 803.*

Next, great stress had been laid by the Commissioner and in the argument here on his behalf, on the existence in the English Income Tax Act of 1918 of section 33. Under that section any assurance company carrying on life assurance business, or any company whose business consists mainly in the making of investments is entitled to repayment of so much of the tax as is equal to the amount of the tax on any sums disbursed as expenses of the management. It is urged that under our Ordinance only life assurance companies are allowed to deduct management expenses, and that no provision to the like effect applies to investment companies. I think this argument is somewhat artificial. The necessity for making special provision in England for life insurance companies and investment companies would depend on the structure of the English Act, which makes provision for a large number of allowances and deductions in a variety of cases. In this connection Konstam in his *Law of Income Tax (7th ed., page 223) says,* "Companies carrying on certain classes of business are liable to be taxed (at the option of the Crown) upon the interest and dividends derived from their investments, instead of being taxed upon the profits of their trade under case 1 of Schedule D. Where there is no assessment of the kind last mentioned, provision is made for relief in respect of any sums disbursed as expenses of management (including commissions) . . . . But for this provision the companies to which it refers would be at a disadvantage as compared with other companies of the same class, who are assessed upon their profits, because expenses of management are deducted before the profits of trade can be ascertained". Konstam adds that the relief is confined to life assurance companies, investment companies and savings banks.

I think that under the English Act the incidence of taxation is not the same as under our Ordinance. For example, no section from the English Act has been cited to us, nor have I been able to discover any section in that Act, which corresponds to section 9 of our Ordinance. I only repeat that the deductions mentioned in section 9 (1) apply to all "sources" of profit and income, and I think the main question which arises in this appeal is the interpretation of the words of that section. I am unable therefore to draw any inference in favour of the Crown's argument in this respect.

Our attention has also been directed to the dictum of Akbar J. in *The Commissioner of Income Tax v. Arunachalam Chettiar*[1], that "the Crown has the choice of assessing . . . . either under head 6 (1) (*a*) or 6 (1) (*e*)". If I may say so with respect, this appears to be an *obiter dictum*. Akbar J. refers to it as "an additional reason" for arriving at his decision. It is to be noted also that the *Salisbury House Estate, Ltd.* case (*vide* supra) was not cited or commented on in that appeal. In any event, we are entitled to review the reasons of the learned Judge in this appeal.

In the result, the appeal is allowed, and the deduction claimed by the appellant company is held to be a proper deduction, and the amount of tax levied is reduced by Rs. 153.96. The appellant company is entitled to the costs of this appeal, and to the return of any amount deposited for the purpose of the appeal.

[1] *37 N. L. R. 145.*

DE KRETSER J.—

I agree with my brother Soertsz.

WIJEYEWARDENE J.—

I have had the advantage of perusing the judgments of My Lord the Chief Justice and of my brothers Soertsz and Keuneman. I do not propose to discuss and analyse the various arguments addressed to us at the hearing of this appeal and considered in the above judgments. I would state my views briefly as follows :—

(*a*) the income of the Company is assessable under section 6 (1) (*a*) as well as section 6 (1) (*e*) of the Income Tax Ordinance and, therefore, the Commissioner's right to assess the income of the Company under section 6 (1) (*e*) cannot be canvassed ;

(*b*) the deductions to be made "for the purpose of ascertaining the profits or income" of the Company should be determined according to the provisions of section 9 (1) as modified by section 9 (3) ;

(*c*) the deductions claimed by the Company are "outgoings and expenses incurred in the production" of the profits or income within the meaning of section 9 (1) ;

(*d*) no effect can be given to section 9 (3) in the present case, as the activities of the Company in producing the relatively small income from interest are so "embedded" in its general activities in producing its aggregate income, that it is not possible to ascertain what small portion of the company's total expenses should be regarded as its expenses in producing the income from interest.

I agree that the order proposed by my brother Keuneman should be made in this case.