1961 *Present:* **T. S. Fernando, J., and Tambiah, J.**

COMMISSIONER OF INLAND REVENUE, Appellant, *and*
D. B. J. DE SILVA, Respondent

S. C. 2 of 1960—Income Tax Case Stated BRA 269

Income tax—Assessable income—Deductions from statutory income—"Annuity"—"Expenditure of a capital nature"—Income Tax Ordinance (Cap. 188), ss. 10, 13 (1) (a).

The assessee, who was a medical practitioner, purchased from S a business of a dispensary carried on by S. He agreed to pay a sum of Rs. 6,000 *as part payment* for the transfer of the business of the dispensary, and to *continue to pay* to S for thirteen months thirty per cent. of the gross monthly income derived from the business of the said dispensary.

After the sum of Rs. 6,000 had been paid, the assessee paid to S, during the period 1st April 1954 to 31st July 1954, a sum of Rs. 6,706, being thirty per cent. of the gross monthly income from the dispensary. He then claimed to deduct this sum of Rs. 6,706 in computing his assessable income for the relevant year of assessment.

Held, that the monthly sums stipulated for in the agreement were in reality part of the purchase price and therefore constituted payments of a capital nature and not a payment by way of annuity within the meaning of section 13 (1) (*a*) of the Income Tax Ordinance. It followed that the assessee was not entitled to have the sum of Rs. 6,706 deducted in the ascertainment of his assessable income.

CASE stated in terms of section 74 of the Income Tax Ordinance (Cap. 188).

A. C. Alles, Deputy Solicitor-General, with *H. L. de Silva*, Crown Counsel, for the appellant.

M. Tiruchelvam, Q.C., with *Clarence de Silva* and *K. Thevarajah*, for the respondent.

Cur. adv. vult.

July 12, 1961. T. S. FERNANDO, J.—

This matter comes up before us by way of a case stated in terms of Section 74 of the Income Tax Ordinance on a question of law. It had been the practice of the Board of Review to formulate the question or questions of law arising on a case, but we were informed by counsel at the hearing that this practice has been discontinued in view of the observations of this Court in the case of *Fernando v. Commissioner of Income Tax*[1].

The facts relevant to the question that calls for answer in this case are relatively simple. The assessee who was a doctor in practice at the relevant times started practice in partnership with one A (another doctor) at a place called Maharagama in August 1952. For the purpose of this partnership business, doctor A by an agreement of 5th August 1952 (which I shall hereinafter refer to as agreement A1) purchased from one S (who was not a doctor) a business of a dispensary carried on by S, also at Maharagama. The agreement provided that A shall pay *as a part payment* a sum of Rs. 6000 on 5th August 1952, and thereafter *continue to pay* to S for a period of twenty-four months commencing from 5th August 1952 and ending on 4th August 1954 thirty per cent of the gross monthly income derived from the business of the said dispensary.

In July 1953 A withdrew from the partnership, and the business was continued thereafter by the assessee as his sole business. He entered into an agreement (which I shall hereinafter refer to as agreement A.2)

[1] *(1959) 61 N. L. R. 313.*

on 8th July by which he agreed to pay a sum of Rs. 6,000 as *part payment* for the transfer of the business of the dispensary, and to *continue to pay* to S for the thirteen months commencing from July 1953 and ending on 4th August 1954 thirty per cent. of the gross monthly income derived from the business of the said dispensary.

In spite of the form in which agreement A.2 was drawn up, it was really designed for the continuance in force of the bargain struck by the agreement A. 1 between S and the assessee's partner A as is evidenced by the circumstance that the assessee was not called upon by S to make the part payment of Rs. 6000 which sum had already been paid by A on 4th August 1952.

The question that has to be adjudicated here is one familiar in cases arising out of the law relating to income tax, viz. whether a particular sum has been paid out by way of an instalment of capital or whether it is a payment in the nature of an annuity.

During the period 1st April 1954 to 31st July 1954 the assessee paid to S a sum of Rs. 6706/-, being thirty per cent of the gross monthly income from the dispensary. Having paid this sum he claimed to deduct it in computing his assessable income for the relevant year of assessment. In the ascertainment of the profits or income of any person from any source, Section 10 of the Income Tax Ordinance provides that no deduction shall be allowed in respect of

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

(*i*) any annuity, ground rent, or royalty. "

In the ascertainment of the assessable income of a person however, Section 13 (1) of the Ordinance permits the deduction from that person's statutory income computed in accordance with the Ordinance of

" (*a*) sums payable by him by way of annuity, ground rent or royalty : "

If, therefore, the payment of a sum of Rs. 6706 can be regarded in law as payment of an annuity, the assessee is entitled to have that sum deducted from his income before tax is computed, while he is not so entitled if the payment constitutes a payment of or by way of capital.

A similar question, arising in circumstances not very different to those with which we are here concerned, came up for consideration recently by this Court in the case of *The Commissioner of Inland Revenue v. Nilgiriya*[1] (S. C. No. 2 of 1959—Income Tax Case Stated No. BRA–260—vide S. C. Minutes of 23.11.60) and this Court held, interpreting a particular agreement, that certain monthly payments of instalments were of a capital nature and did not constitute payment of an annuity. Mr. Tiruchelvam has sought to distinguish that case as being one where the aggregate of the monthly instalments to be paid amounted almost exactly to the fixed sum payable under the agreement, and that the

[1] *(1960) 63 N. L. R. 176.*

agreement the Court there was concerned with was such that it was equated to an agreement by which provision had been made for the payment of a debt in monthly instalments.

Several English cases were cited to us bearing on the question of the difference between the payment of a capital sum and that of an annuity. The effect of the cases decided prior to 1919 is so well summarised in the judgment of Rowlatt, J. in *Jones v. The Commissioner of Inland Revenue*[1] that I can do no better than reproduce that learned judge's words :—

> " but, as I said during the argument, I do not think there is any law of nature, or any variable principle, that because you can say a certain amount is consideration for the transfer of property, therefore it must be looked upon as the price in the character of principal. It seems to me that you must look at every case, and see what the sum is. A man may sell his property for a sum which is to be paid in instalments, and when you see that that is the case, that is not income or any part of it—that was the case of *Foley v. Fletcher*[2]. A man may sell his property for what is an annuity, that is to say, he causes the principal to disappear and an annuity to take its place. If you can see that that is what it is, then the Income Tax Act taxes it. Or a man may sell his property for what looks like an annuity, but you can see quite well from the transaction that it is not really a transmutation of a principal sum into an annuity, but that it is really a principal sum the payment of which is being spread over a time, and is being paid, with interest, and it is all being calculated in a way familiar to accountants and actuaries, although taking the form of annuity. That was *Scoble's case*[3]—when you break up the sum and decide what it really was. On the other hand a man may sell his property nakedly for a share of the profits of a business, and if he does that, I think the share of the profits of the business would be undoubtedly the price paid for his property, but still that would be the share of the profits of the business and would bear the character of income in his hands, because that is the nature of it. It was a case like that which came before Mr. Justice Walton in *Chadwick v. Pearl Life Assurance Company*[4]. It was not the profits of a business, but a man was clearly bargaining to have an income secured to him, and not a capital sum at all, namely, the income which corresponded with the rent which he had before."

Mr. Tiruchelvam, I should add, relied strongly on the actual decision in the case of *Jones v. The Commissioner of Inland Revenue* (*supra*), but it is necessary to remember that it was only the payment of certain " further royalty " by way of an additional consideration that was held in the special circumstances of that case not to constitute part of the capital sum.

[1] *(1919) 7 Tax Cases at 315.*
[2] *(1858) 28 L. J. Ex. 100.*
[3] *4 Tax Cases 618.*
[4] *(1905) 2 K. B. 507.*

In *Commissioners of Inland Revenue v. Ramsay*[1], where the Court was called upon to construe the terms of an agreement for the purchase of a dental practice, it was contended that the practice was sold not for a fixed capital sum, but for a payment down and further annual sums of the nature of income payment. The Court held, however, that the description given to such payments in the agreement was immaterial and that the annual sums paid under the agreement were instalments of capital. *Dott v. Brown*[2] was a case concerning an agreement of compromise in respect of a sum of money owed by which the debtor, inter alia, covenanted to pay to the creditor two sums of money of £1000 each on specified dates and a sum of £250 on each succeeding March 31st so long as the creditor shall live, such covenant to bind the debtor's estate after his death. It was held that the annual payments were instalments of capital and not of income and that the debtor was not entitled to make any deductions in respect of income tax.

Two other cases, (1) *Lamport and Holt Line Ltd. v. Langwell*[3] and (2) *Commissioners of Inland Revenue v. Ledgard*[4], cited to us need examination. They had both been also brought to the notice of the Board of Review. In *Lamport's case* (*supra*) the question arose whether certain payments made to vendors of some company shares were in the nature of trading receipts or whether they were instalments on account of the purchase price. Jenkins L.J., in the course of delivering his judgment in the Court of Appeal holding that the payments were in the nature of trading receipts, stated—at page 200 :—

> "The question in all cases of this sort must be whether there is an agreement to sell at an ascertained or ascertainable price, with a provision made for that price to be paid wholly or in part by instalments. In that class of case, broadly speaking, the payments are capital. Or is there an agreement to sell in consideration of periodical payments amounting to an annuity, so that the payments cannot be regarded as instalments of a capital sum but are referable to the vendor's right to receive an annuity ? In that class of case, generally speaking, the annual payment is to be regarded as income. The matter is one which turns on the construction of each particular agreement."

Turning to an examination of both agreements A. 1 and A. 2 the payment of Rs. 6000 is referred to specifically as a *part payment*. It has not been and it cannot be questioned that that was a payment by way of a capital nature. The payment of the instalments stipulated for in the agreements is referred to as a continuation of payment. The learned Deputy Solicitor-General contended that the parties were throughout stipulating for payment of the purchase price of the business of the dispensary, and that a part payment of Rs. 6000 having been made, an agreement was reached as to the manner in which the balance of the purchase price of the business of the dispensary was to be paid over. Mr. Tiruchelvam,

[1] *(1935) 20 Tax Cases 79.*
[2] *(1936) 1 A. E. R. 543.*
[3] *(1958) 38 Tax Cases 193.*
[4] *(1937) 21 Tax Cases 129.*

on the other hand, argued that by stipulating to receive the instalments S was bargaining to secure for himself the right to receive an income. In support of his argument, he pointed to the fact that in respect of the instalment payments there is no fixed sum agreed upon, but uncertain sums dependent upon the gross monthly income from the dispensary. This argument is, in my opinion, met sufficiently by the decision in *Ledgard's case* (*supra*) which concerned the interpretation to be placed on an agreement of partnership between architects, one of the clauses of which provided that on the death of one of the partners the purchase money for the share of the deceased partner shall be such a sum as the personal representatives of the deceased partner and the surviving partners may agree upon, and, failing agreement, shall be a sum equal to one half of the share of profits for three years commencing from the first day of the month immediately following the death of such partner which would have been payable to such deceased partner had he continued to be a partner during the said period of three years. One of the partners of the firm of architects died, and sums of money representing the purchase money of the share held by the deceased calculated on the basis set out in the agreement were paid in instalments to the personal representatives of the deceased partner. It was contended on behalf of the purchasers that these instalments were annual payments and not instalments of a capital sum. Lawrence J., holding that the payments were instalments of capital stated—(see page 135) :—

> " It is erroneous to say that this is not a capital payment because the purchase money for the deceased partner's share is to be dependent upon what the profits of the business are for the three years succeeding the death of the deceased partner. It is, I think, a fairly common method of arriving at the value of a share in a business, a large part of which share is dependent upon goodwill, to ascertain the value of that share by reference to the profits of business over a certain term of years . . . . . and the fact that annual profits, which are, of course, of an income character, are used as the measure of the sum does not affect the quality of the sum which is arrived at by that method. "

The Board of Review was, in my opinion, wrong in concluding that *Lamport's case* (*supra*) was more in point than the case of *Ledgard* (*supra*) and, construing the particular agreement we are concerned with on this case stated, it does not appear to me to be difficult to conclude that the monthly statements stipulated for in the agreement were in reality part of the purchase price and therefore constitute payments of a capital nature and not a payment by way of annuity. It follows that the assessee is not entitled to have the sum of Rs. 6706/- deducted in the ascertainment of his assessable income.

The assessee must pay the costs of this appeal.

TAMBIAH, J.—I agree.

Appeal allowed.