1973 *Present :* **H. N. G. Fernando, C.J., and Deheragoda, J.**

COMMISSIONER OF INLAND REVENUE, Appellant, *and*
LIFE INSURANCE CORPORATION OF INDIA,
Respondent

S. C. 1 and 2 of 1971—Income Tax Board of Review No. BRA/351

Income tax—Non-resident life insurance company—Ascertainment of profits of such company—Tax payable on income from interest due on Ceylon Government securities—Inland Revenue Act of 1963 as amended by Act No. 18 of 1965, ss. 2, 27 (1) (2), 65 (1), 66 (1), (2) (3).

The assessee-respondent was an insurance company not resident in Ceylon. It carried on the business of life insurance and held shares in Ceylon Companies and also securities issued by the Government of Ceylon. The question disputed in the present Cases Stated related to the assessment of the income tax payable in respect of the income from interest due on Ceylon Government securities held by the assessee. It was agreed that the law applicable was contained in the Inland Revenue Act of 1963 as amended by Act No. 18 of 1965.

Held, (i) that the gross amount of interest payable to the assessee on securities of the Government of Ceylon must be taken into account in the ascertainment of profits for the purposes of the proviso to section 65 of the Inland Revenue Act.

(ii) that the assessee was entitled to a set-off against the amount of tax actually assessed in all these cases, on account of deductions of tax made by the Central Bank from the gross amount of such interest.

CASES stated under the Income Tax Act.

V. S. A. Pullenayegum, Deputy Solicitor-General, with *Shiva Pasupati,* Senior State Counsel, and *Faiz Mustapha,* State Counsel, for the Commissioner of Inland Revenue in both appeals.

S. Ambalavanar, with *C. Pathmanathan*, *P. C. Tittawela*, *P. Sivaloganathan* and *Ranil Wickramasinghe*, for the assessee-respondent in both appeals.

Cur. adv. vult.

November 13, 1973. H. N. G. FERNANDO, C.J.—

The Assessee in these cases is the " Life Insurance Corporation of India ", which has been carrying on in Ceylon the business of life insurance and which has held shares in Ceylon companies and securities issued by the Government of Ceylon. The Assessee has, for the purposes of our Income Tax law, been regarded as a company not resident in Ceylon ; Counsel appearing for the Assessee did not seek to controvert in these cases the position that the Assessee is a company, although he doubted the correctness of that position.

The two Cases Stated relate to the assessment of the income of the Assessee for the years of assessment 1963/64 and 1964/65, and to the income tax paid or payable in respect of that income. But these are in the nature of " Test cases ", and it has been agreed that the opinions of this Court on the questions decided will be applicable in respect of certain other past years of assessment. Although reference was frequently made to sections of the former Income Tax Ordinance, it has also been agreed that the law applicable in all the cases is contained in the Inland Revenue Act of 1963 as amended by Act No. 18 of 1965.

Under Section 65 (1) of the Act of 1963, the profits of a Company from the business of life insurance shall be " the investment income of the Life Insurance Fund ", less deductions for management expenses. But in the case of a non-resident company, the Proviso to this sub-section requires that the profits from life insurance business " ..... shall be ascertained by reference to the same proportion of the total investment income of the Life Insurance Fund of the company as the premiums from life insurance business in Ceylon bear to the total life insurance premiums received by it ".

In the case of the Assessee, there was income from dividends on shares held by the Assessee in Ceylon companies and also income from interest payable on Ceylon Government securities held by the Assessee. In computing the total investment income of the Assessee for the purposes of the Proviso to Section 65, the Inland Revenue has taken into account the gross dividends payable to

the Assessee on these shares and the gross interest payable to the Assessee on these securities. The correctness of this practice was not disputed before us.

Section 27 (1) of the Act provides that a resident company is entitled to deduct, from the amount of any dividend payable to any shareholder, income tax equal to 33 1/3 per cent. of that amount ; and sub-section (2) of this Section enables the Commissioner to order that a deduction at a higher rate than 33 1/3 per cent. be made for such dividends. Deductions under these provisions were in fact made by resident companies from dividends payable on shares held by the Assessee.

Section 66 (1) of the Act provides for similar deductions of income tax to be made by a person who pays or credits to any person or partnership outside Ceylon any sum falling due (*inter alia*) as interest on debentures, mortgages, loans, deposits or advances. Under this provision, the Central Bank of Ceylon, in making payments of interest to the Assessee on securities of the Government of Ceylon, made deductions of 33 1/3% or more from the sums falling due as interest. Although the Board of Review decided in these test cases that these deductions were not lawfully made, Counsel for the Assessee did not seek during the argument before us to contest their legality ; we ourselves can think of no substantial ground for such a contest. It is agreed that the amounts deducted under S. 27 (1) or under S. 66 (1) from dividends or interest payable to the Assessee were in fact paid over to the Inland Revenue.

Section 66 (2) of the Act requires that a person who deducts income tax under sub-section (1) from any sum shall thereupon issue a statement in writing showing *inter alia* the date and amount of the tax so deducted.

It is necessary to quote in full at this stage sub-section (3) of S. 66 :—

> " Where the assessable income of a person includes a sum from which income tax has been deducted in accordance with sub-section (1), he shall be entitled, on production of a statement relating to such sum issued in accordance with sub-section (2), to a set-off against the tax payable by him of the amount of tax shown on such statement. "

The substantial dispute between the Assessee and the Inland Revenue in these cases concerns the construction of this sub-section (3), the contention for the Inland Revenue being that this sub-section has no application in a case in which deductions

have been made from interest payable to a non-resident Insurance Company. If this contention be correct, then the Assessee is liable to pay the full amount of income tax for which he is assessed, no account being taken of the fact that there has been a pre-payment of income tax by means of deductions made under S. 66(1).

The argument on behalf of the Commissioner has been that the set off for which s. 66 (3) provides is allowable only if income tax has been deducted from a sum which is *included* in the assessable income of a person, and that in the present cases the assessable income of the Assessee does not include any such sum.

In these cases, the assessable income of the Assessee is not, as in an ordinary case, computed merely by the addition together of profits from various sources ; instead, the profits are ascertained by the application of the formula specified in the Proviso to Section 65 (1). Strictly speaking therefore it has to be conceded that the interest payable to the Assessee on Government securities was not actually included in the assessable income of the Assessee.

I cannot agree however that this strict construction must be applicable, particularly in a taxing statute, if such a construction leads to the startling result that the total sum actually recovered as tax upon the income of a tax-payer is greater than the sum lawfully leviable on the tax payer's income. Such a construction must be avoided unless a Court is compelled to it by the provisions of the Statute.

The object of S. 66 of the Act is easily understood. When interest is payable to a non-resident person, the debtor is authorised by sub-section (1) to deduct from the gross interest 33 1/3% or more as income tax ; if the deduction of tax is made, the amount deducted is remitted by the debtor to the Commissioner. In this way, the collection of some amount, in respect of income tax anticipated to be payable by the non-resident, is ensured. The certificate issued by the debtor under sub-section (2) evidences the fact that this amount of tax has been so collected. When the assessment of income tax payable by the non-resident is subsequently made by the Inland Revenue, the amount of tax already collected has to be set-off under sub-section (3) against the amount of tax as subsequently assessed.

Thus S. 66 only provides for the collection in advance, through deductions made by the debtor or a non-resident person, of some amount in anticipation of a subsequent assessment of the actual

tax liability of the non-resident. Sub-section (3) then quite understandably provides that when the subsequent assessment of tax liability is actually made, a set-off against the amount of that liability must be allowed because a part of that liability has already been discharged and collected.

Clearly then, S. 66 is intended only to facilitate the collection of income tax payable by a non-resident, and not to impose a charge of income tax. As far as I am aware the charge of income tax is imposed only by S. 2 of the Inland Revenue Act. Having regard to this clear intention of the Legislature in S. 66 to provide only a means of collecting tax in anticipation of a subsequent assessment of tax liability, and of allowing what is so collected to be set off against the assessed liability, the question is whether the language of S. 66 (3) requires the set-off to be made in these cases.

Although in these cases, the interest on Government securities is not *included* in the assessable income of the Assessee, the amount of such interest is in fact included in computing the total investment income of the Assessee's Life Insurance Fund, and this total becomes a dominant factor in ascertaining under the Proviso to S. 65 of the Act the profits upon which the Assessee is assessed for income tax. Since the interest is thus taken into account in the ascertainment of the assessable income of the Assessee, I am satisfied that the assessable income of the Assessee does *include* this interest in the sense contemplated in S. 66 (3).

Although the Central Bank in fact made deductions from interest payable to the Assessee, the Bank was only *entitled* by S. 66 (1) to do so, and was not bound to make these deductions. In fact there are probably many instances in which interest on loans or mortgages is paid to persons out of Ceylon without such deductions of income tax being made at the time of payment.

If then the Central Bank had not made these deductions from interest, the amount legally recovered as tax from the Assessee would have been only the amount (let me call this amount "Rs. T"), which is leviable on the profits ascertained in accordance with the Proviso to s. 65. If however the contention for the Commissioner is correct, the fact that the Bank chose to make the deductions has the consequence that the amount actually collected from the Assessee will be Rs. T *plus* all the sums deducted under s. 66 (1). The Legislature could surely not have intended that the amount actually collected as tax can be greater than the amount lawfully chargeable from an Assessee, merely

because the Central Bank or any other debtor has chosen to make the deductions permitted by s. 66 (1). I repeat in this context that s. 66 (1) does not impose a charge of tax on income, but only permits deductions of tax to be made in anticipation of a subsequent assessment of tax.

The learned Deputy Solicitor-General, on behalf of the Commissioner, insistently argued that the judgment of the House of Lords in the case of *Inland Revenue Commissioners v. Australian Mutual Provident Society*[1] (1947 A. C. p. 605) has an important bearing on the question which arises in the present cases.

Rule 46 in a Schedule to the Income Tax Act of 1918 provided that a non-resident Company is exempt from income tax in respect of interest and dividends from certain United Kingdom securities. The Act contained another rule (Rule 3 of Case III) which made special provision, similar to the Proviso to our s. 65, for ascertaining the profits of a non-resident insurance Company. According to this Rule 3, a certain proportion of the income from investments of the Life assurance fund of such a Company was deemed to be profits on which income tax was to be charged.

The Mutual Provident Society received interest on certain securities referred to in the Rule 46. The Society claimed that, because Rule 46 exempted this interest from tax, the amount of the interest should be excluded in ascertaining its income from investments under Rule 3. The House of Lords rejected this claim. In so doing, Viscount Simon pointed out that Rule 3 did not tax income from investments, but instead taxed "a conventional sum calculated as the Rule directs". That conventional sum had to be calculated by reference to *the income from investments of the life assurance fund;* these words plainly meant all the income from such investments, and they could not justifiably be read to mean *the income from such part of the investments of the fund as are not exempt from income tax.* The fact that Rule 46 exempted certain income from tax was not a ground for giving to the language of Rule 3 a meaning different from the plain meaning.

In the present cases, we are primarily concerned with the meaning of our s. 66 (3), which provides for a set-off, i.e. for giving credit on account of a deduction of tax previously made from an Assessee's income. If, as already stated, s. 66 (3) read by itself is fairly open to the construction that the Legislature

[1] *(1947) A. C. 605.*

intended a set-off to be allowed in cases of this nature, then the fact that s. 65 provides for an unusual mode of ascertaining profits in such cases is at best only a secondary consideration.

The learned Deputy Solicitor-General appears to have formed the impression that the judgments of the House of Lords in the 1947 case had decided the question concerning a right to a set-off, which has now arisen before us. A claim for a set-off was in fact raised in that case, but it was rejected for the simple reason that the English Rule quite naturally and correctly allowed a set-off only if some amount had previously been paid or deducted as tax : since in that case there had been no deduction of tax in advance, the provision for a set-off could not apply. We on the contrary are concerned with cases in which such deductions of taxe have actually been made from income payable to the Assessee.

Counsel for the Assessee did not argue before us, either that *dividends* payable to the Assessee *by certain Ceylon companies* should be excluded for the purpose of the ascertainment of the profits of the Assessee, or that a set-off should be allowed on account of deductions of tax made from such *dividends.* Accordingly, in these two test cases, and in the other cases which were in dispute between the Assessee and the Commissioner before these cases were stated for the opinion of this Court, the gross dividends payable to the Assessee by those companies will be taken into account for the purposes of s. 65 of the Act, and no set-off will be allowed on account of deductions of tax made at the source from such dividends. But we do not have to express an opinion on the correctness of that position.

It is thus only necessary for us to state the following opinions :—

(1) That the gross amount of interest payable to the Assessee on securities of the Government of Ceylon must be taken into account in the ascertainment of profits for the purposes of the Proviso to s. 65 ;

(2) That the Assessee is entitled to a set-off against the amount of tax actually assessed in all these cases, on account of deductions of tax made by the Central Bank from the gross amount of such interest.

We make no order as to costs.

DEHERAGODA, J.—I agree.

Appeals dismissed on the disputed question.