1939 *Present :* **Poyser S.P.J. and Hearne J.**

# NATIONAL BANK OF INDIA *v.* COMMISSIONER OF INCOME TAX

*D. C. Inty. (Special) 59*

*Income tax—Interest on overdrafts given by bank to debtor in London—Change of residence by debtor to Ceylon—Income arising in Ceylon or not—Liability of bank—Income Tax Ordinance, 1932, ss. 5 (1) (b) and 44 (1) (3).*

A, who resided in England in the year 1928, obtained overdrafts from the National Bank of India, Ltd., which were secured by the deposit of shares owned by him in companies registered in Ceylon and by sterling securities, the property of A's brother. It was one of the terms of the contract implied, if not expressed, that both the principal and the interest should be payable to the bank in England. In April, 1936, A became a resident in Ceylon within the meaning of section 33 of the Income Tax Ordinance.

*Held,* that the interest payable on the overdrafts cannot be said to be income "arising in or derived from Ceylon" within the meaning of section 5 (1) (b) of the Income Tax Ordinance and that the National Bank of India cannot be assessed for income tax in respect of the same.

THIS was a case stated for the opinion of the Supreme Court by the Board of Review under section 74 of the Income Tax Ordinance.

The National Bank of India was assessed in the name of its agent, the National Bank of India, Colombo, for the year of assessment 1937-1938 in respect of a sum of Rs. 13,102, as being income arising in or derived from Ceylon by the National Bank of India, Ltd., London. The tax payable has been assessed at Rs. 1,310.20.

The income consisted of interest payable in respect of the year of assessment by a client, who has been resident in Ceylon within the meaning of section 33 of the Income Tax Ordinance as from April, 1936, but who was non-resident for several years prior to that. The interest accrued upon two sterling overdrafts granted to the client in London, while he was resident in London. One of these liabilities was a loan on the security of shares in companies registered in Ceylon and owned by the borrower, on which the interest taxable for the year was Rs. 1,147. The other liability was against sterling securities owned by the client's brother, on which the taxable interest amounted to Rs. 11,955.

Upon these facts the Income Tax Assessor assessed the National Bank of India, London, as having a taxable income arising in or derived from Ceylon equal to the two sums of Rs. 1,147 and Rs. 11,955.

The bank appealed against the assessment of the Commissioner under section 69 of the Income Tax Ordinance and the Commissioner confirmed the assessment. The bank thereupon appealed to the Board of Review under section 71 of the Ordinance. The Board of Review allowed the appeal; whereupon the Commissioner applied to the Board to state a case for the opinion of the Supreme Court.

*J. W. R Ilangakoon, K.C., A.-G.* (with him *S. J. C. Schokman, C. C.*), for Commissioner of Income Tax, appellant.—The question is whether two sums of money which represent interest payable by A, who is now resident in Ceylon, to a Bank in London (non-resident) on two overdrafts given to A while he was in London is taxable.

A has been resident in Ceylon since 1936. The two debts constitute property situated in Ceylon and therefore, the interest derived from them is taxable under section 5 (1) (*a*). *See also sections* 5 (2) and 6 (1) (*e*). The fact that A is in default in the payment of interest to the Bank makes no difference—section 9 (3) of Ordinance No. 2 of 1932, as amended by Ordinance No. 27 of 1934.

The question turns on whether the Bank can be said to have derived any income from property in Ceylon.

The two overdrafts constitute two simple contract debts. They are loans by the bank to a customer who had an account with them. Are they "property"? Is so, are they situated in Ceylon? These debts are choses-in-action and come under section 5 (2). The locality of a simple contract debt must be ascertained with reference to the residence of the debtor—*English, Scottish and Australian Bank, Ltd. v. Commissioners of Inland Revenue*[1]. A case almost on all fours with the present case is *Commissioners of Inland Revenue v. Viscount Broome's Executors*[2].

[POYSER S.P.J.—Was the debt incurred before 1936, before Mr. A. became a resident in Ceylon?]

Yes, but the locality of the debt changes according to the residence of the debtor—*Commissioner of Stamps v. Hope*[3].

*H. V. Perera, K.C.* (with him *N. Gratiaen* and *C.C. Rasaratnam*), for respondent.—If the proposition which has been put forward is accepted, it will have very far reaching consequences. The transaction took place in England, the creditor is in England and the debtor during a particular year, by mere residence for six months, happens to be in Ceylon. Has the creditor to pay income tax under these circumstances? There is obviously a fallacy in the argument.

The proposition relating to the locality of a chose-in-action is entirely a fiction of the law to which the English Courts were driven by necessity. But a chose-in-action cannot be regarded as property within the meaning of section 5 (2). The enactment interpreted in *English, Scottish and Australian Bank, Ltd. v. Commissioner of Inland Revenue* (*supra* definitely included property, both corporeal and incorporeal.

Under our Ordinance, is it correct to say that a chose-in-action arising in respect of transactions or services rendered is property within the meaning of every enactment that one can think of? There is no definition of property in our Ordinance. It does not have the same meaning as would be attached to "property" in action relating to the administration of an estate.

Section 44 of our Ordinance expressly excludes interest on any loan or advance made by a banker. This is a clear indication that interest due on the overdrafts in question cannot be taxed. The case of

[1] (1932) *A. C. 238*

[2] (1935) *19 Tax Cases 667.*

[3] (1891) *A. C. 476.*

*Commissioners of Inland Revenue v. Viscount Broome's Executors* (*supra*) dealt with interest paid on an investment and was decided on its own special facts.

The overdrafts have been treated by the Commissioner of Income Tax as an investment on property situated in Ceylon. The interest due on them is not necessarily nett income. The expenses and losses incurred by the Bank in their business should be taken into account for the purpose of assessment.

The item under consideration has to come under the category of profits of business referred to in section 6 (1) (*a*). It cannot come under any other class, such as section 6 (1) (*e*). No question, therefore, arises as to locality. This is profit from business carried on outside Ceylon.

*Ilangakoon, K.C., A-G.*, in reply.—A chose-in-action is incorporeal property. It has been held that "copyright" is property for income tax purposes. Except by a legal fiction copyright has no absolute local existence.

If investment is made by bank as part of its banking business in Ceylon interest would not be taxed separately under section 6 (1) (*e*). Profits of business would be taxed under section 6 (1) (*a*).

This case falls within the letter of the law as it obtains in Ceylon. Section 81 of the Ordinance enables the Commissioner of Income Tax to levy the tax from the debt itself, if there is default on the part of the bank.

*Cur. adv. vult.*

January 17, 1939. POYSER S.P.J.—

The material facts in this cas eare as follows:—A person referred to throughout the proceedings as Mr. A. became a resident in Ceylon, within the meaning of section 33 of the Income Tax Ordinance, in April, 1936. Prior to that date Mr. A resided in England and had, about the year 1928, obtained overdrafts from the National Bank of India, Ltd., London. Such overdrafts were secured by the deposit of shares in companies registered in Ceylon and by sterling securities, the property of Mr. A's brother.

The Board of Review found that the overdrafts in question were granted to Mr. A when he was resident in England, in pursuance of a contract made there, at a rate of interest fixed with reference to the Bank of England rate of discount, and that it was one of the terms of the contract, implied if not expressed, that both principal and interest should be payable to the Bank in England.

The Board of Review held, reversing the Assessor and the Commissioner of Income Tax, that the interest payable on these overdrafts is not income of the National Bank of India, Ltd., London, "arising in or derived from Ceylon".

The Commissioner of Income Tax appeals from that finding.

The Attorney-General argued that Mr. A's overdraft was a simple contract debt, that in law a debt was situated wherever the debtor was resident for the time being, and that as Mr. A resided in Ceylon from April, 1936, the obligation to pay interest on the debt arose in Ceylon from that date and that such interest was liable to Ceylon Income Tax.

The case he principally relied on was *English, Scottish and Australian Bank, Ltd. v. Commissioners of Inland Revenue* [1].

In that case it was held that an agreement for the sale of (amongst other things) simple contract debts owed by debtors resident out of the United Kingdom is exempt from *ad valorem* stamp duty in respect of such debts upon the ground that they are "property locally situate out of the United Kingdom" within the meaning of the exception in section 59, sub-section (1) of the Stamp Act, 1891.

In Lord Buckmaster's judgment the following passages occur:—

(Page 245). "But debts do, in one form or another, represent property of very considerable value in the modern world, and it appears to me it is desirable that they should possess a locality, even if they are invested with it by means of a legal fiction. Nor can I see why, when that locality has been attributed for several centuries for purposes of jurisdiction in the administration of estates, it should be regarded as impossible when dealing with the Stamp Act".

"It is in my opinion a fair assumption that the Statute was passed with knowledge of the well established law relating to probate, and the phrases then used would be perfectly proper to cover debts where the debtors were out of the United Kingdom".

(Page 246). "If however, once it be assumed that a debt must have a local situation, as I think it must, it can only be where the debtor or creditor resides, and the fact that it has for other and similar purposes been assumed to be determined by the residence of the debtor and not the creditor is a sufficient reason for holding that that is its situation for the purpose of the Statute".

If the argument of the Attorney-General succeeds the consequences will be far-reaching.

No doubt many Ceylon residents incur debts in the United Kingdom, not only overdrafts but debts for goods supplied and if the payment of such debts or the interest on them renders the payees liable to Ceylon Income Tax, it is difficult to foresee what the consequences would be. In the great majority of cases it would be no doubt be impracticable to collect such tax. The present case is exceptional in that National Bank of India have a branch in Colombo who are agents for the bank's office in London.

There is a further difficulty in regard to upholding the argument of the Attorney-General. The Commissioner of Income Tax has assessed the Bank on the interest due on the overdrafts without any deductions. He has treated such overdrafts as an investment on a property situated in Ceylon when it is common ground that the interest payable to a bank on overdrafts is not necessarily nett income,—all the expenses incurred by the bank in their business, bad debts, &c., have to be taken into account in assessing their income.

When the attention of the Attorney-General was drawn to this aspect of the case he argued that it was no hardship on the bank as they would get credit for the amount of Ceylon Income Tax they paid from the Inland Revenue.

[1] *(1932) A. C. 238.*

I have very considerable doubts on that point but I think the fallacy of the Attorney-General's argument lies in treating an overdraft incurred in England by a person at the time resident in England as something in the nature of an investment in Ceylon when the debtor became resident in Ceylon.

I do not think legal fictions can be applied to the Ceylon Income Tax Ordinance and in the latter I can find no provisions under which this assessment can be upheld. In fact the reverse appears to be indicated, for in section 44 which deals with interest, &c., payable to persons out of Ceylon, the following occurs:—

> Section 44 (1) (iii)—" this section shall not apply to any interest paid out of income not arising in Ceylon, or to interest on any loan or advance made by a banker ".

In this case it was not suggested that the interest on the overdrafts was remitted from Ceylon, in fact interest was not paid at all but added to the overdrafts, and I agree with the Board that such interest cannot be said " to arise in or be derived from Ceylon ".

The decision of the Board is confirmed and the Bank is entitled to the costs of the proceedings in the Supreme Court.

HEARNE J.—I agree.

*Appeal dismissed.*