

1963 Present : Basnayake, C.J., Abeyesundere, J., and  
G. P. A. Silva, J.

COLOMBO ELECTRIC TRAMWAYS AND LIGHTING CO., LTD.  
Appellant, and COMMISSIONER OF INLAND REVENUE,  
Respondent

*S. C. 11—Income Tax Case No. BRA/E. 30*

*Excess Profits Duty—Cessation of a business activity—Payment of gratuity thereafter to the employees—Right of employer to deduct the sum in assessing profits—Income Tax Ordinance (Cap. 188), s. 10 (c).*

The assessee was a non-resident company which carried on business in Ceylon. On 31st August 1944 its activity of running electric tramcars was acquired by the Municipal Council of Colombo in the exercise of its rights under a contract executed in 1896 which gave the Municipal Council the right to purchase the business on giving a year's notice. The persons employed by the assessee were taken into the service of the Municipal Council. Under their terms of employment with the assessee they were entitled to receive a gratuity at the end of their period of service. After the acquisition by the Municipal Council, the assessee paid its employees a sum of Rs. 107,986 as gratuities.

*Held*, that the sum of Rs. 107,986 was allowable as a deduction in ascertaining the profits for the Excess Profits Duty assessment. The fact that the gratuities were paid after the cessation of the business made no difference.

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

*H. W. Jayewardene, Q.C.*, with *M. Sivagurunathan*, for Assessee-Appellant.

*V. Tennakoon*, Deputy Solicitor-General, with *M. Kanagasunderam*, Crown Counsel, for the Assessor-Respondent.

January 29, 1963. BASNAYAKE, C.J.—

The assessee, the Colombo Electric Tramways and Lighting Company, was a non-resident company which commenced to carry on business in Ceylon in the year 1901. Until the year 1927 the assessee carried on in Ceylon the activity of running electric tramcars by virtue of a contract with the Municipal Council of Colombo, executed in 1896, which gave the assessee the exclusive right of running tramcars in

Colombo subject to the right of the Municipal Council to purchase the business on giving a year's notice. The assessee also acted as electrical contractors and suppliers of electric current for lighting. Separate accounts were kept of each of those activities.

Between the years 1927 and 1928 the assessee's activity of generating and supplying of electric current for lighting was taken over by the Government, and the assessee ceased to engage in that activity thereafter. On 31st August 1944 the activity of running electric tramcars was acquired by the Municipal Council of Colombo in the exercise of its rights under the contract referred to above. The persons employed by the assessee in this activity were taken into the service of the Municipal Council. There remained only the activity of electrical contract work which the assessee carried on till 14th August 1945 on which date the business was sold to the United Planters of Ceylon Ltd., whereupon the assessee company went into voluntary liquidation.

After its acquisition by the Municipal Council the assessee paid those who were its employees in the activity of running electric tramcars a sum of Rs. 188,946 as gratuity. The minutes of the Board which relate to the payment of gratuity are as follows :—

“ 1. Minutes of Board Meeting held on 28th September 1943 :

Superannuation gratuity etc.	
Cable 22nd September from B. Bros.	
Daily paid employees 15 years and over gratuity payable	
Strikers calculated three quarters	Rs. 79,416
Additional one month's pay	.. 7,365
Daily paid employees one week's pay per	
year for those under 15 years	.. 22,447
	Total .. 109,228

The Board sanctioned a gratuity on the above basis to be paid when the personnel concerned cease to be employees of the Company.

2. Minutes of the Board of Meeting held on 16th January 1945 :

Gratuity to clerks and Inspectors (after take-over of tramways by Municipality)

Rs. 40,000 was allocated by the Board for payment of a gratuity to the Clerks and Inspectors in recognition of their past services.

The Board resolved that the Company goes into liquidation and that the necessary steps be taken to accomplish this.

3. Minutes of the Board Meeting held on 3rd July 1945 :

The Board authorised the following payments :

To Mr. B. B. Anderson	..	Rs. 25,000
To Mr. D. J. O. Gray	..	12,000 (one year's salary)

as gratuities on leaving the Company's service and taking employment with the Colombo Municipality."

From the inception of the assessee's business in Ceylon, in 1901, till the year 1931 the employees enjoyed the benefits of a provident fund to which both employer and employee contributed. In the latter year the provident fund scheme was wound up by paying over to each employee the contributions made by him together with the contributions made by the employer, and a superannuation scheme was introduced. Under that scheme it would appear that an employee on leaving the assessee's service became entitled to a gratuity. The assessee's right to deduct payments made under the superannuation scheme in ascertaining the profits from the assessee's business does not appear to have been disputed ; but the deduction, in ascertaining the profits from the business of the assessee, of the payment made to the assessee's employees on the acquisition of the activity of running tramcars is disputed on the following grounds :—

(a) that the sum of Rs. 188,946 was paid by the assessee to the employees in the tramcar service because there was a cessation of business and was not paid for the purpose of carrying on that business.

(b) that the sum of Rs. 107,986, Rs. 43,775 and Rs. 37,185 paid by the assessee were voluntary payments made to the employees and that no liability to pay them was incurred by the assessee until the date of payment. As these three sums of money were paid after the assessee had ceased to carry on the activity of running tramcars the payments were outgoings of a capital nature.

The Board sought to distinguish the payments made under the superannuation scheme to employees who left the service while the assessee was engaged in the activity of running tramcars from the payments made after it ceased to carry on that activity on the ground that in the former category were persons who retired from the service of the company and that in the latter category were persons whose services were terminated "under certain circumstances". In their reasons the Board observe :

“ The employees would not have received the sum of Rs. 188,946 at the time they received it if the tramway business of the appellant company had not been taken over by the Municipal Council. This payment on account of gratuities had been definitely incurred as a result of cessation of the tramway business. These payments were voluntary payments. ”

It is conceded that the payment of Rs. 43,775 and Rs. 37,185 do not fall within the year of assessment to which this appeal relates. The learned Deputy Solicitor-General does not seek to maintain that the electric tramways is a separate business in view of the fact that all these years all the activities of the assessee including the tramways have been treated as one business.

The fact that the assessee paid a gratuity on retirement must undoubtedly have been a matter which the assessee's employees took into consideration in entering into the company's service on the salaries they were offered. It is the recognition of that fact that made the Income Tax authority to refrain from disallowing the deductions of gratuities paid in respect of those employees who retired from service while the assessee was engaged in the activity of running tramcars. The employees who were in service when the take over occurred were also persons, like their predecessors who had retired, who, in accepting the salaries they were offered when they entered the service, took into account the fact that at the end of their period of service they would receive a gratuity. The fact that the gratuities now in question were paid on the cessation of the activity makes no difference. We have no doubt that the payments, not only do not fall within section 10 (c) as expenditure of a capital nature, but that they are also deductible in ascertaining the profits from the assessee's business. Our opinion is that the sum of Rs. 107,986 is allowable as a deduction in arriving at the profits for the Excess Profits Duty assessment for the accounting period commencing on 1st January 1944 and ending on 31st December of the same year.

We therefore remit the case to the Board in order that they may revise the assessment in accordance with our opinion.

The appellant is entitled to the costs of this appeal and the refund of the fee paid under section 74 (1) of the Income Tax Ordinance.

ABEYESUNDERE, J.—I agree.

G. P. A. SILVA, J.—I agree.

*Appeal allowed.*