1935 *Present :* **Dalton S.P.J. and Maartensz J.**

COMMISSIONER OF INCOME TAX *v.* P. K. N.

27—(Inty.) Income Tax.

Income tax—Firm carrying on import business in rice—Assessment of profits—Deduction of expenses—Freight on rice, carried in firm's sailing vessels—Income Tax Ordinance, No. 2 of 1932, s. 9.

The assessees are a firm carrying on business in Jaffna as importers of rice from India. The firm owned sailing vessels in which they carried their own cargo as well as cargo for other merchants. The shipping business was a separate business controlled from their office in India and carried on independently of the business of importing and selling rice in Ceylon.

The assessees deducted from the profits made on their business as dealers in rice the freight they would have charged other merchants for carrying their goods to Ceylon.

Held, that the assessees were entitled to charge only the actual cost of carriage to themselves and not the full amount of the freight they would have charged others.

THIS was a case stated under the Income Tax Ordinance by the Board of Review upon the application of the Commissioner of Income Tax.

The question of law stated is as follows :—" The question which arises is whether, in law, the respondents are entitled to deduct, as the cost of carriage of the rice imported to Ceylon for sale in Ceylon, the full sum with which they have charged themselves as the cost of carriage (such sum being calculated at the rate at which they would have charged any other person had such rice been shipped to Ceylon by such other person) or whether they can only deduct the actual cost of carriage ".

M. W. H. de Silva, Acting S.-G. (with him *Basnayake, C.C.*), for appellant.—The assessee carries on the business of a rice merchant in Ceylon. He has a fleet of vessels in which he imports his rice and he also carries goods for others to and from Ceylon. Although he debits his rice business with the full freight he would have charged an outsider if he carried rice for him, he is not entitled to claim the full freight as an " expense " or outgoing of the rice business. He is entitled to charge what it costs him to bring the rice to Ceylon and is not entitled to make a profit out of himself by subdividing his various activities. Section 9

permits the deduction of outgoings and expenses incurred. An "outgoing" means something that has gone out, an expense which someone has been at [*43 L. J., p. 144 at p. 146*]. "Expenses incurred" means money actually paid out (*118 E. R. p. 737.*) *Mayor of West Ham v. Grant*[1], *Commissioner of Income Tax v. Antell*[2].

Although the accounts of the rice business and the shipping activities are separately kept, the position is not altered. The taxing authority is not bound by the way in which an assessee keeps his accounts.

H. V. Perera (with him *N. Nadarajah and Aiyar*), for respondent.—The shipping business and the rice business are separate activities and the shipping business, not being a business carried on in Ceylon, is not taxable as the assessee is a non-resident person. If the assessee is not allowed to deduct the full freight on the rice from the profits of the rice business it will amount to an indirect taxation of the profits of the shipping business which cannot be taxed in Ceylon.

Commissioner of Income Tax v. Antell (*supra*) cited by the Acting Solicitor-General is not applicable to this case.

Counsel cited passages from the Income Tax Manual and referred to the following cases: *Commissioners of Inland Revenue v. William Ramson & Son*[3], *Commissioners of Inland Revenue v. Maxse*[4], *Commissioner of Income Tax v. Steel Bros. & Co., Ltd.*[5]

M. W. H. de Silva, Acting S.-G. in reply.—Only deductions allowed are those enumerated in section 9 and "outgoings and expenses incurred". Cited 2 *T. C.* 387 at 397, 3 *T. C.* 22 at 37.

Cur. adv. vult.

December 13, 1935. MAARTENSZ J.—

This is a proceeding under the Income Tax Ordinance, 1932. It is brought before us upon a case stated by the Board of Review upon the application of the Commissioner of Income Tax.

The case stated sets out certain facts but the Board has not stated its findings upon those facts. We did not refer the matter back to the Board as the respondents' contention was that the opinion expressed by the Board upon the point of law dealt with was right, whatever view we took of the facts.

The facts shortly stated are as follows:—The respondents, hereafter referred to as the assessees, are a firm of five partners, all of whom are not resident in Ceylon, carrying on business in Colombo as money-lenders and in Jaffna as money-lenders, importers of rice from India, and exporters of tobacco to India. The assessees own four sailing vessels in which they carry their own cargoes to Jaffna as well as cargo for other merchants.

The shipping business was, according to the assessees, treated as a separate business controlled from their office in India and carried on quite independently of the business of importing and selling rice in Ceylon. Accordingly, the assessees deducted from the profits made on their

[1] (*1889*) *58 Ch. p. 123.*
[2] (*1902*) *A. C. 422.*
[3] (*1918*) *L. R. 2 K. B. 709.*
[4] (*1919*) *1 K. B. 647, 12 T. C. 41, 11 T. C. 524.* *2 I. T. C. 17 Hal. p. 149.* (*1926*) *11 T. C. 508.* *at pp. 520 and 521, Konstam (4th ed.)p. 143.*
[5] (*1925*) *Income Tax Cases (Indian) vol. II., p. 119.*

business as dealers in rice the freight they would have had to pay if the rice was carried to Ceylon in ships not owned by them. The freight deducted was determined by the freight the assessees charged other merchants for carrying their goods to Ceylon.

The amount charged as freight is not stated nor is there a finding that the amount charged is reasonable.

The assessor held that in arriving at the true profits earned in Ceylon from the business of importing and selling rice the assessees were not entitled to deduct the full amount of the freights they had charged themselves, but were only entitled to deduct the actual cost of carriage to themselves.

The actual cost of carriage is not stated but according to the case stated the assessees accepted the amount fixed by the assessor. The difference between the amount of freight the assessees charged themselves and the actual cost allowed by the Commissioner is Rs. 16,243.

On appeal to the Commissioner, the Assistant Commissioner confirmed the assessment made by the assessor and the assessees appealed to the Board of Review. The decision of the Board is as follows :—

"The Board is of opinion that the appellants, who are non-residents, are entitled to deduct the sum of Rs. 16,243 which is the difference between the amount of the actual cost of the carriage of the rice to themselves, as computed by the assessor, and the amount which the appellants have debited themselves with, on their rice accounts, as the freight for the carriage of their rice to Ceylon at the rate they would have charged had they carried the rice for someone else.

'The appeal is accordingly allowed and the assessment is reduced by the sum of Rs. 16,243'."

The Commissioner of Income Tax being dissatisfied with the decision of the Board of Review, this case was stated by the Board.

The question of law stated is as follows :—"The question which arises is whether, in law, the respondents are entitled to claim to deduct, as the cost of carriage of the rice imported into Ceylon for sale in Ceylon, the full sum with which they have charged themselves as the cost of carriage (such sum being calculated at the rate at which they would have charged any other person had such rice been shipped to Ceylon by such other person) or whether they can only deduct the actual cost of such carriage, the difference between the charges at these different rates being agreed at the above sum of Rs. 16,243."

The arguments before us proceeded on the footing that it made no difference whether the assessees carried on the shipping business as an independent business or not. On behalf of the Commissioner it was contended that in terms of section 9 of the Income Tax Ordinance only the actual costs of carriage to the assessees could be deducted. On behalf of the assessees it was contended that, if the profits in the shipping business were separable from the business in rice, the assessees were entitled to allot to that business as profits the fireight they would have to pay if the ships did not belong to them.

The question to be decided would be only of academic interest if the profits derived by the assessees from the carriage of goods to Ceylon were taxable in Ceylon, for in that case it would be immaterial whether the

income tax was paid on the profits of the shipping business or on the profits of the business in rice. But under the provisions of section 39 (1) of the Income Tax Ordinance only the profits on goods carried from Ceylon are deemed to arise in Ceylon. The profits which the assessees seek to exclude from their profits of the rice business are not taxable in Ceylon if the contention of the assessees is upheld.

The Solicitor-General relied on the terms of section 9 of the Ordinance which provides that, subject to the provisions of sub-sections (2) and (3), there shall be deducted, for the purpose of ascertaining the profits or income of any person from any source, all outgoings or expenses incurred by such person in the production thereof.

The section further provides that outgoings and expenses shall include (*a*) such sum as the Commissioner in his discretion considers reasonable for the depreciation by wear and tear of plant, &c.; (*b*) certain losses on plant, &c., sold or discarded; (*c*) any sum expended for the repair of plant, &c.; (*d*) such sum as the Commissioner in his discretion considers reasonable for bad debts; (*e*) interest paid or payable to a banker; (*f*) any contribution made by a public officer under the Widows and Orphans Pension Fund Ordinance, 1898; (*g*) any contribution to a pension . . . . fund which may be approved by the Commissioner.

It is unnecessary to refer to the sub-sections which are not material to the question to be decided.

The Solicitor-General argued that section 9 was exhaustive and that subject to the deductions provided for by sub-heads (*a*) to (*g*) the assessees were only entitled to deduct, for the purpose of ascertaining their profits from the business in rice, such outgoings or expenses as were actually paid out or became payable in the production of those profits; and that the assessees were therefore not entitled to deduct from those profits the amount of freight which they would have had to pay if the shipping did not belong to them as such amount could not be brought under any of the provisions of section 9.

In support of his argument the Solicitor-General referred us to two cases: (1) *Dublin Corporation v. M'Adam* (*Surveyor of Taxes*[1]) and (2) *Dillon* (*Surveyor of Taxes*) *v. Corporation of Haverfordwest*[2].

In the first case the assessed profits of the Dublin Corporation included the income derived by the Corporation from rates levied by them for water supplied within the Municipal area and from the sale of water within and without such area.

At the hearing of the appeal by the Commissioners the respondent applied that the assessment might be amended by excluding therefrom the income derived from rates, and that the Corporation should be charged with duty on the income derived by them from the supply of water outside the limits of compulsory supply, and from the supply of water within those limits for purposes of trade, manufacture and otherwise, after allowing therefrom a deduction of a proportionate part of the expenses.

The decision of the Commissioners was, that the Corporation was liable to pay income tax upon the profit of so much of this waterworks concern.

[1] (1887) 2 *Tax Cases* 367.

[2] (1891) 3 *Tax Cases* 31.

as was derived by the supply of water to the extra-municipal area. The Corporation being dissatisfied with this decision the Commissioners stated a case for the opinion of the High Court.

Palles C.B. made the following observation which was relied on by the Solicitor-General:—" What we have to consider, in my opinion, is whether, in relation to the extra-municipal districts, the Corporation of the City of Dublin are carrying on a trade, adventure, or concern in the nature of a trade ; for if they are, I am clear that whatever surplus may remain of the receipts incident to that concern over the expenses of that concern is a profit within the meaning of the Act. On the other hand, I think it is perfectly clear that, in order to bring this case within the operation of the Income Tax Act, it is necessary that there shall be this trading in its strict true sense. There must be, at least, two parties—one supplying water, and the other to whom it should be supplied and who should pay for it. If these two parties are identical, in my opinion there can be no trading. No man, in my opinion, can trade with himself ; he cannot, in my opinion, make, in what is its true sense or meaning, taxable profits by dealing with himself ; and in every case of this description it appears to be a question on the construction of the Act whether the two bodies—the body that supplies and the body or class which has to pay—were either identical, or, upon the true construction of the Act, must be admitted to have been held by the Legislature to be identical, and so legislated for upon that basis ".

He then held that the Corporation could not make a profit from the rates as they were the agents and representatives of the ratepayers, and could not be treated as in any sense a body distinct from the inhabitants of Dublin ; but that as regards water supplied to persons or townships within the extra-municipal limits that principle could have no application as the suppliers and the persons supplied were distinct persons.

In the second case it was held that a Municipal Corporation owing gasworks and supplying gas free for the public lamps and at a charge to private consumers could not deduct from the profits of supplying private consumers the expenses of lighting public lamps.

Charles J. in the course of his judgment made an observation similar to that of Palles C.B.

It is, I think, perfectly clear from the principle laid down in these two cases that a person cannot be assessed for income tax on profits he might be said to have made from himself. Accordingly, if the assessees carried goods from Ceylon in their own ships they cannot be assessed for income tax on the profits they would have derived from carrying the goods of other persons.

On the same principle I am of opinion that the assessees are not entitled to deduct from the profits of the rice business what they would have had to pay in the way of freight to other persons as the profits made in their shipping business, which is not taxable for income tax in Ceylon.

The respondents relied on two cases in which the question for decision was whether a business carried on by the assessee was liable to excess profits duty, and it was held that the proper course when a trade or

business liable to duty is carried on in connection with a trade or business not so liable is to sever the profits of the two businesses and assess accordingly.

In the first case (*Commissioners of Inland Revenue, Appellants, v. William Ransom & Son, Limited, Respondents*[1]), "The respondents, who were a limited company carrying on business as manufacturing chemists and growers of medicinal and other herbs, owned a factory where the manufacture and distillation of herbs were carried on, and they also occupied a farm on which they grew herbs for treatment in the factory. Memoranda were kept of the value of the produce transferred to the factory, of the prices obtained by the sale of incidental crops to the public, and of the expenses relating to the farm operations. The respondents were assessed to excess profits duty, and on an appeal by them against the assessment, the General Income Tax Commissioners found as a fact that the respondents occupied the farm mainly for the purpose of the factory, but they were of opinion that the occupation of the farm was the business of husbandry, and that the profits of the farm should be excluded for the purpose of excess profits duty, and they fixed the assessment on this basis:—

"It was held, (1) that on the facts there was evidence on which the General Commissioners could find that the company was engaged in husbandry, and (2) that as it was possible for the Commissioners to separate the business of husbandry from the other business, there was nothing in law to prevent them from doing so."

The ruling in this case was followed in the case of *Commissioners of Inland Revenue v. Maxe*[2], where the Court of Appeal held, I quote the head note, "That M. was carrying on the profession of a journalist, author or man of letters, and also the business of publishing his own periodical. The publishing business should be debited with a fair and reasonable allowance in respect of M.'s contributions, and a proper sum for his remuneration as editor, and on that footing he would be liable to duty in respect of his business, but exempt therefrom in respect of his profession."

The Solicitor-General contended that these cases were decided on the language used in the sections relating to excess profits duty, particularly sub-section (1) of section 40.

Part III. of the Finance (No. 2) Act, 1915, imposes a duty of an amount equal to fifty per cent. on the profits of a business exceeding by more than two hundred pounds the pre-war standard of profits as defined for the purposes of this part of the Act.

By section 39 of the Act certain trades and businesses are exempted from payment of this duty.

Sub-section (1) of section 40 of the Act provides that—

"(1) The profits arising from any trade or business to which this part of this Act applies shall be separately determined for the purpose of this part of this Act, but shall be so determined on the same principles as the profits and gains of the trade or business are or would be determined for the purpose of income tax, subject to the modifications set out in the First Part of the Fourth Schedule to this Act and to any other provisions of this Act."

[1] *(1918) L. R. 2 K. B. 709.*

[2] *(1919) L. R. 1 K. B. 647.*

In view of the provisions of this sub-section it was necessary, in the two cases referred to, to determine separately the profits of the businesses liable to pay excess profits duty. Accordingly a reasonable allowance was allowed to be debited against the profits of the businesses liable to duty in respect of the benefits derived by them from the businesses not liable to pay that duty. But that principle cannot be applied to the case under consideration where what has to be determined is the profits to the assessees from the trade or business in rice. The respondents were not able to refer us to any case in which it was so applied and the absence of authority is I think against the contention of the respondents.

The respondents also cited the case of *The Commissioner of Income Tax v. Steel Bros. & Co., Ltd.*[1] where the assessees had a head office in London, and it was held that in arriving at the amount of profits assessable under the Act the head office in London should be allowed a reasonable commission agent's commission on the sales and realization of produce shipped from Burma, and such a commission would not be assessable.

This case is of no assistance as no reasons are given for the decision that the assessees are entitled to deduct the commission payable to a commission agent. It is certainly not deductable under any of the provisions of section 9 of our Ordinance.

In my opinion the assessees cannot claim to make a profit in their shipping business by trading with themselves and are therefore not entitled to deduct from the profits of their business in rice the amount they would have to pay as freight if the rice was carried to Ceylon in the ships of another person.

I would accordingly allow the appeal with costs incurred in this Court. The taxable income will stand at Rs. 48,243 and the tax payable at Rs. 4,824.30.

DALTON S.P.J.—I agree.

Appeal allowed