1941 *Present :* **Hearne and Wijeyewardene JJ.**

HAUGHTON TEA COMPANY, LIMITED *v.* COMMISSIONER OF INCOME TAX.

INCOME TAX APPEAL No. 113—5.

Income Tax—Planting of estate with budded rubber—Ordinary precautionary measure—Expenditure not of capital nature—Permissible deduction—Income Tax Ordinance, ss. 9 (1) (c) and 10 (c) (Cap 188).

Where a rubber estate was replanted with budded rubber by the owner as an ordinary precautionary measure inseparable from the running of the estate on business lines,—

***Held*, that the expenditure was a permissible deduction under section 9 (1) (c) of the Income Tax Ordinance.**

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

The appellant Company, which owns Haughton estate, purchased Siriniwasa estate at an execution sale under a mortgage decree on February 29, 1936. Soon after the acquisition of the estate, the appellant Company decided upon a replanting programme with budded rubber.

The Income Tax Assessor was of the view that the sums expended by the Company on replanting could not be wholly allowed as deductions in computing profits of the Company and made additional assessments under section 65 of the Income Tax Ordinance disallowing the expenditure of replanting in 1936, 1937 and 1938 although in the earlier assessments the entire expenses of each of those three years had been allowed as deductions. Additional assessments were accordingly made on the appellant Company for the years 1937-38, 1938-39 and 1939-40.

Both the Commissioner and the Board of Review subsequently upheld the contention of the assessor.

H. V. Perera, K.C. (with him *E. F. N. Gratiaen*), for the appellant.—The reassessment is based on a misapplication of certain English cases.

Section 6 (1) (*a*) of the Income Tax Ordinance refers to profits from, *inter alia*, any business, and "business" would, under section 2, include any agricultural undertaking. It is submitted that deductions should be allowed in this case either under the general provisions of section 9 (1) or under section 9 (1) (*c*).

The periodical replacement of trees is done in the ordinary course of the business and is an expenditure normally incurred in keeping alive the source of income. The source of income in the present case is the business and not the tree ; the rubber tree is only an item in the business. The change of ownership of Siriniwasa estate would not make any difference. The Commissioner has misapplied *The Law Shipping Co., Ltd., v. The Commissioners of Inland Revenue*[1] ; and *The Commissioners of Inland Revenue v. The Granite City Steamship Co., Ltd.*[2] By replanting trees we were only doing something which the previous owner would have done. The replanting did not amount to the addition or improvement of a physical asset. Where there is a continuity in the business the two English cases are inapplicable. Change of ownership is immaterial unless it corresponds to a discontinuance of the old business.

[1] *12 T. C. 621*

[2] *13 T. C. 1.*

On the basis of the previous assessments replanting was encouraged. The reassessment, therefore, would cause much hardship.

H. H. Basnayake, C.C., for the respondent.—The question is whether the expenditure incurred in replanting can be regarded as capital expenditure. If it is capital expenditure, the applicability of section 9 need not be considered at all.

The *Shipping Company* case (*supra*) is not applicable to the facts of this case. Nor can the usual practice of the Commissioner of allowing deductions for replanting be justified. The additional assessments can, however, be supported on the ground that the expenditure incurred in replanting is expenditure of a capital nature falling under section 10 (c) of the Income Tax Ordinance. Each tree is, in theory, an asset in the production of the income. There is no difference between a new plantation and a replantation. Any expenditure "for the enduring benefit of the business" is capital expenditure. See *The Vallambrosa Rubber Co., Ltd., v. Farmer*[1]; *Theobald v. Commissioner of Income Tax*[2]; *Hyam v. Commissioners of Inland Revenue*[3]; *Atherton v. The British Insulated and Helsby Cables*[4]; *Commissioner for Inland Revenue v. George Forest Timber Co., Ltd.*[5] No part of section 9 would be applicable in a case like this—*The Rhodesia Railways, Ltd., et al. v. Commissioner of Taxes (Southern Rhodesia)*[6]; *Income Tax Case No. 180*[7]; *Margrett v. Lowestoff Water & Gas Co.*[8]; *Ainley v. Edens*[9]; *Income Tax Case No. 184*[10]; *Hyam's Case (supra)*; *Thornhill v. Commissioner of Income Tax*[11].

The provisions of the Income Tax Ordinance are to be strictly construed however great the hardship it may cause see (*Income Tax Case No. 146*[12]); *Income Tax Case No. 184*[13].

E. F. N. Gratiaen, in reply.—The only question before the Commissioner was the applicability of the *Shipping Company* case (*supra*). It is not, therefore, necessary to consider section 10 (c) of the Income Tax Ordinance. The Commissioner himself has followed the practice of treating replanting ordinarily as revenue expenditure, apparently on the authority of *Rhodesia Railways, Ltd. v. Collector of Income Tax, Bechuanaland Protectorate*[14]. No Rubber tree which is planted in place of another can possibly be regarded as a permanent improvement. By the replanting programme we were only substituting one wasting asset, for another wasting asset. Consumable assets should be distinguished from permanent assets—see judgment of Scrutton L.J. in *Atherton's* case (*supra*).

Cur. adv. vult.

February 28, 1941. HEARNE J.—

This is an appeal by the Haughton Tea Company, Ltd., on a case stated by the Board of Review under section 74 of the Income Tax Ordinance. Arguments by Counsel for the Company and the Assessor who appeared before the Board have been summarized in the reference to

[1] *5 T. C. 529.*
[2] *41 N. L. R. 539.*
[3] *14 T. C. 486.*
[4] *10 T. C. 155, at p. 192.*
[5] *(1914) A.D. (S. Africa) 516, 524 et seq.*
[6] *1 S.A.T.C. 133.*
[7] *5 S.A.T.C. 256.*
[8] *19 T. C. 481.*
[9] *19 T. C. 303.*
[10] *5 S. A. T. C. 270.*
[11] *40 N. L. R. 313.*
[12] *4 S.A.T.C. 280.*
[13] *5 S.A.T.C. 268, 272.*
[14] *(1933) A.C. 368.*

us, but the particular point of law requiring decision by this Court was not stated. It has, however, been possible to gather it from a minute in which the Commissioner of Income Tax set out the reasons for his decision from which the Company appealed to the Board.

The assessee Company purchased Siriniwasa estate on February 29, 1936, and in that year replanted five acres with "budded rubber". In 1937, 139 acres were replanted and in 1938, 100 acres. The expenditure incurred in these years was Rs. 6,391, Rs. 31,111 and Rs. 36,723 respectively. The Commissioner allowed the above-mentioned sums to be deducted in computing the profits of the Company during the years in question. It is clear from a perusal of his minute, to which I have referred, that his original ruling had been that the deduction was admissible under section 9 (1) (c) of the Ordinance. Further, the implication flowed from that ruling that the deduction was not expressly prohibited by section 10 (c), as being in respect of an expenditure of a capital nature.

At a later stage, however, he made additional assessments after deducting the whole of the expenditure of replanting in 1936, Rs. 25,000 of the sum expended in 1937 and a further Rs. 25,000 of the sum expended in 1938. He indicated unambiguously why he had revised his first view.

It was not because "budded" and not ordinary rubber had been planted; it was not because he had overlooked section 10 (c); it was not because he thought the interpretation that had hitherto been placed on section 9 (1) (c) was wrong; it was, in his opinion, because while the allowance is admissible to make up to the owner of a wasting asset the deterioration caused by its use by him, such allowance is not admissible to make up to the owner the deterioration caused by its use by a previous owner. In the former case, as he had hitherto held, the cost of replanting would be a proper charge against receipts; in the latter case, he thought, the expenditure would be of a capital nature.

Against this view Counsel for the Company contended before the Commissioner and the Board. He submitted that the object of the outlay was not to bring the estate into a better condition, *i.e.*, to effect any improvement in it, but that "the programme of replanting was the normal programme of a certain percentage (of trees) being planted each year".

The Board supported the Commissioner and, in doing so, was in my opinion wrong. Its decision was based on a misapprehension of the principle to be derived from the *Law Shipping case*[1].

In that case, as the head-note reads, the appellant Company purchased a second hand ship at a date when her periodical Lloyd's survey was overdue, but had been deferred pending the completion of a voyage. On her return, six months later, the survey was made and the Company was obliged to spend a large sum in repairs. It was held that except for such part of the cost of repairs as was attributable to the period during which the ship was employed in the appellant Company's trade, the expenditure in question was in the nature of capital expenditure, and was not an admissible deduction in computing the Company's profits.

[1] *12 T. C. 621.*

The grounds for the view that was taken are clearly set out in the judgment of the Lord President. "The purchasers started their trade with a ship already in need of extensive repairs . . . . When they started to trade with the ship, the capital they required was not limited to the price paid to acquire her, but included the cost of the arrears of repairs which their predecessors had allowed to accumulate".

That was not the position in this case. Siriniwasa estate was not in a poor condition at the time of its acquisition. The Commissioner accepted a statement to this effect from a representative of the Company. Replanting took place, not to repair the neglect of years so as to enable the estate to yield a return, as the ship in the *Law Shipping* case (*supra*) had to be made serviceable before any trade with her was at all possible, but as an ordinary, precautionary measure inseparable from the running of a rubber estate on business lines.

Counsel who appeared for the Commissioner found himself unable—and in my opinion quite rightly—to support the additional assessments on the ground that his client was right in his view of the law based on *12 Tax Cases 621* and affirmed by the Board.

This, properly, is the end of the matter before us—the determination of the issue between the Commissioner and the Company which the latter unsuccessfully carried to the Board and thence to this Court.

The Board, however, expressed its views on section 10 (*c*) and section 9 (1). In its opinion no deduction should be allowed, in any circumstances, in respect of expenditure involved in replanting, as such expenditure is capital expenditure under section 10 (c) and, in particular that it does not fall within the "general words of section 9 (1)": and Counsel for the Commissioner who, at this stage, really constituted himself Counsel for the Board (I say this without in any way meaning to give offence), associated himself with the opinions expressed and invited this Court to endorse them. But he went further and argued that the practice of the Income Tax Department based upon the applicability of section 9 (1) (c) was wrong.

I am of opinion that this is neither the time nor the occasion to challenge the practice of the Department in regard to section 9 (1) (c). It was not canvassed before the Board. The sub-section, the Commissioner says, has been generously interpreted and his reasons for giving it a generous interpretation are not known to us. It would, I think, be most inappropriate to express any opinion on a matter which affects a wide public and which is not involved in the reference, without the advantage of hearing the Commissioner and merely on the submissions of Counsel who, while formally appearing for him, does not represent his views. The interpretation of section 9 (1) (c) might, and probably will, involve a consideration of questions of fact as well as of law. It is not to be assumed that the commissioner, even if he has acted, in the past, as he felt generously, did so arbitrarily.

I am also of the opinion that the *obiter dicta* of the Board in regard to "the general words of section 9 (1)" do not call for comment. The Commissioner's view was based on section 9 (1) (c); while, in regard to section 10 (c), I do not think the Board had before it the material to

express an opinion on the thorny question of whether the expenditure was of a capital nature. Certainly no reasons were given by the Board for its opinion.

The question of what is capital expenditure is one of fact which must be decided on available data and in accordance with principles that have been laid down. In *Atherton v. British Insulated and Nelsby Cables, Ltd*[1], Viscount Cave said that "when an expenditure is made not only once and for all but also with a view to bringing into existence an asset or an advantage for the enduring benefit of a trade, there is very good reason for treating such an expenditure as properly attributable, not to revenue but to capital", but he qualified this by saying that "there may be special circumstances leading to an opposite conclusion".

There may be special circumstances obtaining in the rubber industry known to the Commissioner but of which the Board and we are unaware. It does not appear to me that the expenditure involved in replanting, in the substitution of an asset subject to waste for another wasting asset, effects any "permanent improvement"—to use the phrase of Lord Macmillan in *Rhodesia Railways, Ltd. v. Collecter of Income Tax*[2]—in an estate, and it may be that it is generally regarded as an essential *revenue* expenditure for the purpose of maintaining a certain requisite level of productive efficiency. At any rate, without full knowledge of the facts, the question is incapable of decision.

For the purpose of this appeal I assume but, in all the circumstances, do not decide that the past practice of the Income Tax Department is in accordance with the law. The ground, however, on which the Commissioner made his additional assessments and departed from the established practice of the Department under his control is not, for reasons which I have given, sustainable and the Board was, in my opinion, wrong in upholding him.

The appeal must, therefore, be allowed with costs and the additional assessments annulled.

WIJEYEWARDENE J.—I agree.

Appeal allowed.