

[PRIVY COUNCIL]

1971 *Present*: Lord Cross of Chelsea, Lord Hedson, Lord Kilbrandon,
Sir Frederic Sellers, and Sir Benjamin Ormerod

THE COMMISSIONER OF INLAND REVENUE, Appellant, and
J. M. RAJARATNAM, Respondent

PRIVY COUNCIL APPEAL NO. 7 OF 1971

S. C. 3/67—Case Stated Income Tax BRA/339

Income tax—Voluntary deeds of covenant to pay annuities—Payments made thereunder—Right of covenantor to deduct the same from his assessable income—Meaning of word “annuity”—Income Tax Ordinance (Cap. 242), ss. 5 (1), 6 (1), 11 (1) (g), 12 (i) (j), 13 (1), 15 (1) (a)—Stamps Ordinance, 1909, s. 26 (a).

The assessee-respondent voluntarily and without any pecuniary consideration executed two deeds of covenant whereby he covenanted to pay each of his two brothers annually a sum of Rs. 1,500. Accordingly two payments totalling Rs. 3,000 were made by him to the brothers in the fiscal year 1957/1958.

Held, that the two payments under the deeds of covenant were permissible deductions in the calculations of the respondent's assessable income for the fiscal year 1958/1959. The two sums could fairly be described as “annuities” within the meaning of section 15 (1) (a) of the Income Tax Ordinance. The word “annuity” does not mean only a purchased annuity. This view receives support from the wording of section 26 of the Stamps Ordinance.

APPEAL from a judgment of the Supreme Court reported in (1969) 73 N. L. R. 128.

D. C. Potter, with *G. P. S. de Silva*, for the assessor-appellant.

S. Ambalavanar, with *Cuda Tittawella*, for the assessee-respondent.

Cur. adv. vult.

December 8, 1971. [*Delivered by LORD CROSS OF CHELSEA*]—

This is an appeal by the Commissioner of Inland Revenue of Colombo with the leave of the Supreme Court of Ceylon from an order of that Court made on 10th December 1969 holding in answer to questions in a case stated by the Board of Review that two payments totalling 3,000 rupees, made by the respondent Jesuthasan Mylvaganam Rajaratnam in the fiscal year 1957/1958 were permissible deductions in the calculations of his assessable income for the fiscal year 1958/1959.

The payments in question were made under two deeds of covenant each made on 1st February 1958 by the respondent in favour of one of his brothers. That in favour of his brother Mylvaganam Paramanathan ran as follows:

“ DEED OF COVENANT

COVENANT TO PAY AN ANNUITY

“ I, Jesuthasan Mylvaganam Rajaratnam of No. 30, Boswell Place, Colombo 6, in consideration of the natural love and affection I have for my brother Mylvaganam Paramanathan hereby covenant that for a period of seven years from the year ending 31st March, 1958 (being treated as the 1st year) or during the residue of my life, whichever period shall be shorter, I will pay annually to the said Mylvaganam Paramanathan during his life the sum of Rs. 1,500 (one thousand and five hundred rupees).

In witness whereof I have hereto set my hand and seal this 1st day of February, 1958.”

The other deed was in the same terms with the substitution of the name of the other brother Mylvaganam Sathanathan for that of Mylvaganam Paramanathan.

The relevant provisions of the Income Tax Ordinance 1932 (as amended) are as follows:

“ CHAPTER II

IMPOSITION OF INCOME TAX

5. (1) Income tax shall, subject to the provisions of this Ordinance and notwithstanding anything contained in any other written law or in any convention, grant, or agreement, be charged at the rate or rates specified hereinafter or fixed by resolution under section 23, for the year of assessment commencing on the 1st day of April, 1932, and for each subsequent year of assessment in respect of the profits and income of every person for the year preceding the year of assessment—

(a) wherever arising, in the case of a person resident in Ceylon, and

(b) arising in or derived from Ceylon, in the case of every other person.

• • • •

6. (1) For the purposes of this Ordinance, 'profits and income' or 'profits' or 'income' means—

.....

- (e) dividends, interest, or discounts ;
- (f) any charge or annuity ;
- (g) rents, royalties, and premiums ; and
- (h) income from any other source whatsoever, not including profits of a casual and non-recurring nature.

.....

CHAPTER III

ASCERTAINMENT OF PROFITS OR INCOME

11. (1) Subject to the provisions of subsections (3), (6) and (7), there shall be deducted, for the purpose of ascertaining the profits or income of any person from any source, all outgoings and expenses incurred by such person in the production thereof, including—

.....

- (g) interest paid or payable to a banker ;

.....

12. For the purpose of ascertaining the profits or income of any person from any source no deduction shall be allowed in respect of—

.....

- (i) any interest paid or payable other than that allowed under section 11 (1) (g) ;
- (j) any annuity, ground rent, or royalty ;

.....

CHAPTER IV

ASCERTAINMENT OF STATUTORY INCOME

13. (1) Save as provided in this section, the statutory income of every person for each year of assessment from each source of his profits and income in respect of which tax is charged by this Ordinance shall be the full amount of the profits or income which was derived by him or arose or accrued to his benefit from such source during the year preceding the year of assessment, notwithstanding that he may have ceased to possess such source or that such source may have ceased to produce income.

CHAPTER V

ASCERTAINMENT OF ASSESSABLE INCOME

15. (1) The assessable income of a person for any year of assessment shall be his total statutory income for that year subject to the following deductions :—

- (a) sums payable by him for the year preceding the year of assessment by way of interest not allowable under section 11 (1) (g), annuity, ground rent, or royalty :

Provided that—

- (i) where under section 13 the statutory income arising from any source has been computed by reference to the profits or income of any period other than the year preceding the year of assessment, the interest, annuity, ground rent, or royalty payable in respect of such source shall be computed on the like basis ;
- (ii) no deduction shall be allowed in respect of any sum payable by way of interest, annuity, ground rent, or royalty by a person out of Ceylon to another person out of Ceylon ;”

.....

It will be convenient at this stage to refer to some provisions in the United Kingdom Income Tax legislation which may be said to correspond in a general way to those in the Ceylon Ordinance set out above since reliance has been placed on certain differences between them. Section 123 (1) of the Income Tax Act 1952 says (*inter alia*)—

“ Tax under Schedule D shall be charged under the following Cases respectively, that is to say—

.....

Case III—tax in respect of—

- (a) any interest of money, whether yearly or otherwise, or any annuity, or other annual payment, whether such payment is payable within or out of the United Kingdom, either as a charge on any property of the person paying the same by virtue of any deed or will or otherwise, or as a reservation out of it, or as a personal debt or obligation by virtue of any contract, or whether the same is received and payable half-yearly or at any shorter or more distant periods ;”

.....

Section 169 (1) of the Act provides that where any yearly interest of money annuity or annual payment is payable wholly out of profits or gains brought into charge to tax no assessment shall be made on the

person entitled to the interest, annuity or annual payment but that the person liable to make the payment in question though not entitled to deduct it from his profits or gains assessed to tax is entitled to deduct and retain out of it a sum representing tax at the standard rate on it.

The notable differences between the Ceylon Ordinance and the United Kingdom Act are, of course, first that in the Act the word "annuity" is not used by itself but is followed both in section 123 and in section 169 by the words "or other annual payment" and secondly that the Ordinance—unlike the Act—does not provide for deduction of tax at source. The recipient of the "annuity" is taxed directly in respect of it and the payer pays it "gross" to the annuitant and is entitled to a deduction from his assessable income in respect of it.

The respondent paid the two sums of 1,500 rupees to his brothers in the fiscal year 1957/1958 and they were assessed to and paid income tax on the payments—though whether the payments were treated as annuities falling under section 6 (1) (f) or as income from any other source falling under section 6 (1) (h) does not appear. It is also to be observed that the two deeds of covenant were charged to Stamp Duty under section 26 of the Stamps Ordinance 1909 (as amended) which so far as relevant runs as follows:

"Section 26. Any instrument for the creation or sale of any annuity or other right to a periodical payment not before in existence, whether created by actual grant or conveyance or only secured by bond, warrant of attorney, covenant, agreement or otherwise, shall be chargeable with the same duty as on a conveyance of movable property for the consideration set forth in such instrument. If no consideration is so set forth, the consideration shall be deemed to be—

(a) where the annuity or periodical payment is for a definite period not exceeding twenty years so that the total amount to be paid can be previously ascertained, such total amount;"

The respondent in his tax return for the year 1958/1959 claimed that in computing his assessable income he was entitled under section 15 (1) of the ordinance to deduct the two sums paid under the deeds of covenant as "annuities". The deduction having been disallowed the respondent appealed to the Commissioner under section 73 (1) of the Ordinance and by order dated 1st December 1966 the Deputy Commissioner who heard the appeal confirmed the assessment. The reasons given by the Deputy Commissioner for his decision were that the cases showed that in the United Kingdom Act the word "annuity" only covered a right to receive annual payments which the annuitant had purchased by the expenditure of a capital sum—thus converting his capital into income; that payments under deeds of covenant such as those in the instant case would not be regarded in the United Kingdom for tax purposes as "annuities" but as "annual payments"; and that as the Ceylon

Ordinance did not contain the words "or other annual payments" the payments in question were not deductible. The respondent appealed from the decision of the Deputy Commissioner to the Board of Review which dismissed his appeal on 23rd June 1967. The reasons given by the Board for holding that the payments were not deductible were, however, quite different from those given by the Deputy Commissioner—namely that they were not attributable to any source of income and were not therefore expenditure or of an income character. At the request of the respondent the Board stated a case for the opinion of the Supreme Court which on 10th December 1969 held that the two payments were deductible as annuities. The judgment of the Court, given by Samerawickrame J. and concurred in by Weeramantry J., does not deal at all with the reasons given by the Board of Review for disallowing the deductions; but counsel for the appellant told their Lordships that he could not advance any argument in support of those reasons and placed no reliance on them. The reasons given by the Supreme Court for disagreeing with the conclusion of the Deputy Commissioner were—briefly stated—that a right to receive recurring annual payments which are income in the hands of the payee can properly be described as an "annuity" even though the payee has not acquired the right by purchasing it for a capital sum but in some other way—(as for example by testamentary bequest or under a voluntary covenant) and that there is no warrant for putting on the word as used in the ordinance the limited meaning which the Deputy Commissioner put on it.

Their Lordships agree with this conclusion. The argument that in the United Kingdom income tax legislation the word "annuity" means only a purchased annuity rests on a passage in the judgment of Baron Watson in the case of *Foley v. Fletcher*¹. In that case the plaintiff had sold certain property to the defendants for a capital sum to be paid by half yearly instalments over a period of years. The defendants claimed the right to deduct income tax from each instalment under section 40 of the Income Tax Act 1853 which was in similar terms to section 169 (1) of the Act of 1952 but the plaintiffs claimed that the instalments were capital receipts and not liable to tax. The Court was not in any way concerned to consider in that case what types of annual payment were comprehended under the word "annuity" as opposed to the words "or other annual payment". The question before them was whether instalments of purchase price could be regarded as "an annuity or other annual payment" within the meaning of the Act. It was in relation to that problem that Baron Watson used the words which are relied on by the appellant in this case—namely "this payment is said to fall within the description of an annuity. But an annuity means where an income is purchased with a sum of money, and the capital has gone and has ceased to exist, the principal having been converted into an annuity. Annuities are made chargeable by express words. The words

¹ (1858) 3 H. and N. 769.

'other annual payments', in the same section, mean payments *cjusdem generis*, viz. as profits". In their Lordships' view these words read in their context mean no more than that there is a distinction to be drawn between the purchase of an annuity for a sum of money and the sale of property for a stated price with a provision for the payment of the price by instalments. The words in question have been quoted with approval in several later cases but always in the same context as that in which Baron Watson used them—namely where the question at issue was whether the payment was received as capital or as income. Their Lordships do not think that either Baron Watson or the judges who have quoted his words with approval were considering what distinction is to be drawn between the word "annuity" and the words "or other annual payments" as used in the income tax legislation or were suggesting that the word "annuity" should be given a more limited meaning in that legislation than it normally bears. In the United Kingdom as the Act contains the words "or other annual payment" the question whether any given payment which admittedly falls under one or other head should be described as "an annuity" or not is only of academic interest. But payments under deeds of covenant such as those executed by the respondent can, their Lordships think, fairly be described as "annuities" and they observe that in the case of the *I. R. C. v. Duke of Westminster*¹ where the Duke had executed covenants of this type in favour of some of his employees and claimed to deduct the payments under them for tax purposes Lord Tomlin in his speech in fact referred to them as "annuities". Counsel for the appellant did not himself go so far as to accept Baron Watson's words as a completely accurate definition of what is meant by the word "annuity" in the ordinance since he conceded that where a testator bequeaths an annuity to A and his estate subject to the annuity to B, B must be entitled to deduct the annuity under section 15 (1) even though A did not purchase it but acquired it by an exercise of the testator's bounty. The definition of the word "annuity" as used in the ordinance which counsel advanced was "periodical payments of the same or similar amounts payable for a definite or indefinite period being pure income of the recipient and derived from the surrender or extinction of capital or from a donation of capital". But their Lordships see no reason for excluding an annuity secured by covenant from the scope of the word "annuity" as used in the ordinance—especially as the acceptance of counsel's definition might, as he admitted, lead to a distinction being drawn between a case where the creator of the annuity had transferred a fund to trustees upon trust to pay the annuity out of the income or if necessary the capital and subject thereto to hold the fund upon trust for himself and a case where he had covenanted to make the payments in question but had vested a fund in trustees as security for his performance of his obligations under the covenant and to be held subject thereto upon trust for himself.

¹ (1936) A. C. 1.

The fact that the ordinance refers only to "annuities" and not also to "other annual payments" may possibly have the result—whether intended or unintended—that some payments from which tax could be deducted under the United Kingdom Act as "annual payments" but which cannot fairly be described as "annuities" are not deductible under the ordinance; but their Lordships agree with the Supreme Court that the payments under these deeds of covenant can fairly be described as annuities. They would add that this view receives support from the wording of section 26 of the Stamps Ordinance 1909 set out above.

Their Lordships will therefore humbly advise Her Majesty that the appeal be dismissed. The appellant must pay the respondent's costs of the appeal to the Board.

Appeal dismissed.
