1948 *Present :* **Jayetileke S.P.J. and Canekeratne J.**

THE NATIONAL MUTUAL LIFE ASSOCIATION OF AUSTRALASIA, LTD., Appellant, *and* THE COMMISSIONER OF INCOME TAX, Respondent.

S. C. 69—Income Tax : Case Stated.

Income Tax—Ascertainment of profits of insurance companies—Revenue and capital expenditure—Interpretation of section 42 of the Income Tax Ordinance (Capl 188).

The National Mutual Life Association of Australasia, Ltd., carrying on life insurance business in Ceylon through a branch office in Colombo, established a Staff Superannuation Scheme early in 1917, and paid pensions to its employees in accordance with the provisions of that Scheme. It contributed sums out of its profits and the employees made contributions under that Scheme. The contributions made by the Association to the fund of this Scheme amounted up to the early part of 1944 to a sum of about £65,000. About February, 1944, a valuation of the Assets and Liabilities of the Superannuation Fund was made and a deficit of actual liabilities over assets of £150,000 was disclosed. The Association paid the sum of £150,000 to four persons called the Trustees of the Staff Superannuation Fund on February 23, 1944 ; the sum was paid in order to prevent annual sums having to be paid later and to be able to fulfil its promises to its employees.

Held, that the payment of the sum of £150,000 was an ordinary business expense and that, under section 42 of the Income Tax Ordinance, a fair proportion of the sum was deductible from the insurance company's profit for the year of assessment 1945–1946 as expenses of the head office.

CASE stated under the provisions of the Income Tax Ordinance.

H. V. Perera, K.C., with *D. W. Fernando*, for the assessee, appellant.—The old Staff Superannuation Scheme of 1917 was, according to the documents marked in the case, superseded by the fresh scheme of 1944. This is therefore a case of a conversion of an old scheme into a new one. The old scheme existed even before 1944 ; the sum of £150,000 is not an initial contribution to start a scheme. Section 9 of the Income Tax Ordinance (Cap. 188) defines the word " profits " ; the profits contemplated by that section are the profits which should be ascertained for a particular year by deducting only such outgoings and expenses as are incurred in the production of the income. The assessee concedes that the expenditure referred to in this case is not incurred in producing the income, but it is submitted that this is in the nature of a recurring expenditure, not an initial contribution, because the obligations under the old scheme already existed in 1944.

Section 10 of the Income Tax Ordinance is ancillary to section 9—section 9 includes certain things while section 10 excludes certain other things. The " premia " referred to in section 42 cannot be considered " income ". It is difficult to say in any particular case whether a certain

item is revenue or capital expenditure.—See *Sundaram on Income Tax (4th Ed.) at p. 387.* The special cases contemplated in sections 21, 22, &c., do not have any bearing on the interpretation of section 42. For a definition of " income " see *Commissioner of Inland Revenue v. Australian Mutual Society, Annotated Tax Cases Vol. 26 at p. 261.* The case of *Atherton v. British Insulated and Helsby Cables Ltd. (1924–1926) 10 Tax Cases 155* is distinguishable from the present case as firstly it is not an initial contribution, and, secondly, in the present case the liability is one which already existed under the old scheme of 1917.

Whether a certain expense is a legitimate expense is a question of fact. It is not disputed that where an expenditure is incurred for an enduring benefit of a business it should be considered capital and not revenue expenditure. But in section 42 one is dealing with some arbitrary method of calculation of income, the figure referred to in that section being a conventional figure and not a figure representing the actual profits. Hence it is inappropriate to utilise the provisions of sections 9 and 10 in interpreting the word " expenses " in section 42. Sections 9 and 10 are applicable to cases where one starts with a gross income and makes certain deductions of expenses incurred in the production of that income ; these rules cannot therefore be made applicable to section 42, which prescribes a conventional method of arriving at the " income " ; no expenses can be incurred in arriving at an income which is merely conventional. The only question is whether it is a necessary and legitimate expense ; on this question the principles enunciated in *10 Tax Cases at p. 155* are in appellant's favour.

M. F. S. Pulle, K.C., Solicitor-General, with *H. Deheragoda, Crown Counsel,* for the Commissioner of Income Tax.—" Expenses of the head office " in section 42 of the Income Tax Ordinance means head office expenses incurred in the ordinary course of the business of the head office and not a sum spent by the head office for the benefit of all employees, including those employees overseas. For the meaning of " income " in the proviso to section 42 and section 42 (4) see definition of " profits " or " income " in section 2. Section 5 (1) gives the mode in which tax should be assessed ; section 6 (1) gives a definition of " profits " or " income "—Cf. also section 2. The deductions to be made in arriving at the income should be in the nature of revenue and not of capital expenditure—See judgment of Lord Blanesburgh in *Atherton v. British Insulated and Helsby Cables Ltd. (1924–1926) 10 Tax Cases 155 at p. 203 ; vide also pp. 179, 180 and 192.* If the expenditure cannot be regarded as forming part of the cost by which those profits and gains have been acquired, nor as an expenditure which, however prudent from the employer's point of view, was essentially necessary for the acquisition, in that or any subsequent year, of any portion of the profits and gains of the business, it cannot be regarded as revenue expenditure—*Vide* Lord Atkinsons judgment at p. 199. Money spent on buying the good will of a business is expenditure of a capital nature—*Associated Portland Cement Manufactures, Ltd. v. Inland Revenue Commissioners (1946) 1 A. E. R. 68.* The provision in the Income Tax Act, 1918, corresponding to section 42 of our Income Tax Ordinance is section 33 of that Act.—

Vide Law of Income Tax by *Konstam (10th Ed.) at p. 412–413.* On what "management expenses" mean see *Bennet v. Underground Electric Railways Co. of London, Ltd., (1918–1924) 8 Tax Cases 475 at p. 480; London County Freehold and Leasehold Properties, Ltd. v. Sweet (1942–1943) 24 Tax Cases 412; The North British and Mercantile Insurance Co. v. Easson (1913–1921) 7 Tax Cases 463 at p. 473.*

H. V. Perera, K.C., in reply.—The only question is whether in assessing the head office expenses a fair proportion of the contribution made to the provident fund should be allowed. In *Atherton's* case it was held that such expenditure was a proper and necessary expense of the head office—See *10 Tax Cases at pp. 182, 190 and 191.* See also *Ushers Wiltshire Brewery Ltd. v. Bruce (1915) A. C. 433.* The question whether there is a balance of profits and gains does not arise when considering section 42; the term "expenses of the head office" is wider than "management expenses" used in the same section.

Cur. adv. vult.

June 4, 1948. CANEKERATNE J.—

This is an appeal by way of Case Stated from a decision of the Board of Review confirming an assessment to income tax of a proportionate part of a sum of £150,000.

The Association carries on a life insurance business, having its head office in Melbourne, in the State of Victoria, but it has a branch in Colombo through which it carries on a portion of its life assurance business. The appeal relates to the computation of the assessable income arising from the total investments of the Colombo branch for the year 1945–1946 and turns on the proper interpretation and application of section 42 of the Income Tax Ordinance, Cap. 188 of the Ceylon Legislative Enactments. The interpretation which was primarily favoured by the Crown was that sections 9 and 10 of the Income Tax Ordinance applied to the business of the Association. It was next argued that the contribution in question did not form part of the expenses of the head office. Both these contentions prevailed with the Board.

Insurance business is a unique form of business in which the making of forward contracts is seen altogether in an extreme form. In the very nature of things it is impossible to state the income of insurance companies for any particular period with accuracy; and the most careful calculation can only be regarded as an estimate. There cannot obviously be an annual stock-taking in the customary acceptation of that term. Life policies are contracts of most variable endurance and the premiums are in many cases not annual payments. The contracts may endure for the policy-holder's life, or for a certain number of years, or till the holder attains a certain age; and the company may be bound on the expiry of a fixed number of years, or on the attainment of a certain age by the policy-holder, either to pay a lump sum or an annuity for the remainder of the policy-holder's life. The premiums paid for such insurance may be paid all in one sum or by instalments within a fixed number of years, or annually during the holder's life or during the

subsistence of his policy. The premiums, therefore, do in no sense represent the annual profits and gains of the company. In like manner, the amount of claims in one year arising on the death of persons insured, or as a deduction from the company's receipts for the year, cannot afford any criterion for the ascertainment of profits. The profits and gains can be ascertained only by actuarial calculations in which the burden of the unexpired risks is taken into account[1]: estimates have to be made of the net rate of interest that will be earned, of the mortality of the policy-holders, and of the percentage of premiums needed to meet expenses. The actuarial calculation may be obtained by taking the result of the quinquennial investigation prescribed by statute as in England for assurance companies or by an investigation covering a period of years as is prescribed by the English Income Tax Acts (schedule D); the result of the investigation may be utilised for the purposes of the Income Tax. The true profits of a life insurance business cannot be ascertained in the normal manner prescribed by the Income Tax Ordinance, the basis of ascertaining the gross profits of a trading concern is inapplicable to a life insurance undertaking. The sections prescribing the permissible deductions (section 9 and 10) are also inapplicable. No provision is made in the Ordinance for asertaining the profits of a life insurance business by means of a valuation. In a valuation the probable future requires to be carefully scrutinised and gauged in the light of the experience acquired, both as regards the rate of mortality likely to be exhibited among the assured, the rate of interest at which the accumulated fund and prospective premiums can be profitably and soundly invested, and the adequacy of certain other matters. What is being taxed in this country is not profits but income from investments.

Section 42 (1) provides the basis for ascertaining the profits of a life insurance business. The rule itself is expressed in clear terms, and one is not entitled to read into it anything which is not there, unless on the true construction of the Ordinance as a whole there is some statutory provision which must be treated as modifying it, in order to give it its true effect.

In sub-section 4 of section 42, there is no justification for reading "the whole of its income from investments" as though it ran "the whole of its income calculated in accordance with sections 6, 9 and 10." Giving the word "income" the meaning in the interpretation clause would not, as the Solicitor-General contended, be decisive, for the income of a life insurance company would be calculated in accordance with the provisions of the Ordinance if the basis proposed in section 42 is applied.

The main portion of section 42 (1) applies to a life insurance company resident in Ceylon. The object of this portion is to enable a life insurance company which, unlike a trading company, is not assessed and has no account into which its expenses of management can be brought, to obtain relief in respect of those expenses (including commissions) attributable to that business. The rule applicable to foreign companies carrying on life insurance business in Ceylon through a branch or agency is contained

[1] *Liverpool and London and Globe Insurance Co. v. Bennett (1913) A.C. p. 617.*

in the proviso to section 42 (1) which provides as follows :—

> " Provided that where such a company which is not resident in Ceylon transacts life insurance business in Ceylon whether directly or through an agent, the profits therefrom shall be the same proportion of the total investment income of the Life Insurance Fund of the company as the premiums from life insurance business in Ceylon bear to the total life insurance premiums received by it, subject to a deduction of agency expenses in Ceylon (including commission) and a fair proportion of the expenses of the head office of the company, due account being taken in each case by set off against such expenses of any income or profits other than life insurance premiums or investment income."

In ascertaining the profits of the Ceylon branch or agency one must take a fraction of the total investment income of the Life Insurance Fund of the company and debit against it agency expenses in Ceylon (including commission) and a fair proportion of the expenses of the head office of the company. It directs how the fraction is to be arrived at, and naturally involved a comparison between two totals, one attributable to the life insurance business as a whole and the other attributable to the Ceylon part of it. There is no dispute as to what the proper fraction is in this instance—it is 3646751/100000000. The association made a contribution of a sum of £150,000 to the Trustees of the Superannuation Fund. The only question arising on this appeal is whether or not, the sum so paid is a part of the expenses of the head office of the company. If the Crown is right the payment attracts income tax, if the appellant is right income tax is not payable on a fair proportion of this sum.

All that a person spends—one may be inclined at the outset to think—are his expenses but a little reflection will suggest a modification of the earlier view : he may spend money in purchasing an article, here he gets a thing in exchange for the price ; it would be incorrect to include the purchase price among the expenses. If a person carrying on a business gave money to a needy man he met on the road it may be difficult to include this among the expenses of the business. The salaries paid by him to his employees would be a proper item of expenditure. The moneys spent must have some relation to the trade or business. All the disbursements made in the course of, and for, the trade may generally be the expenses of the trade : they are incurred for the purpose of earning the profits.

To determine whether a sum spent is a proper debit item to be charged against the incomings of the trade it would be necessary to ascertain the reason for incurring the expenditure. Is it in substance a revenue or a capital expenditure ? Expenditure that is going to recur every month or every year would fall within the former class—so salaries paid to employees. A sum of money regularly paid to retain the services of the existing and future members of the staff and of increasing the efficiency of the staff would be expended for the purposes of the trade. Pensions, allowances or gratuities paid by an employer to his servants on retirement or as a reward for long and faithful service fall within the class. But money spent on the purchase of property, tangible or intangible, as the

goodwill of a business, a chose in action,[1] money spent on obtaining foreign exchange,[2] or money spent on acquiring an asset as the construction of a building, is in the nature of capital expenditure. A payment spent once and for all may be capital expenditure or may properly be chargeable against revenue expenditure—instances of the latter are a gratuity paid to a reporter on his retirement, the purchase of an annuity for the benefit of an actuary who has retired. In *Atherton's* case[3] it was decided that when an expenditure is made, not only once and for all, but with a view to bringing into existence an advantage for the enduring benefit of a trade, this payment was in the nature of capital expenditure. The payment, in that case, was made to form a nucleus of the pension fund which it was desired to create. Without this contribution the pension fund might not have come into existence at all.

It was not disputed by the Solicitor-General that an annual contribution made by the appellant to the Superannuation Fund in the future would fall within revenue expenditure and would thus be an expense of the head office. But the Solicitor-General contended that the sum of £150,000 was an initial contribution to the establishment of the Trust Fund and that this payment brought into existence an advantage for the enduring benefit of the Association. It is necessary, therefore, to examine what was done by the Association. It established a Staff Superannuation Scheme early in 1917, and paid pensions to its employees in accordance with the provisions of that Scheme. It contributed sums out of its profits and the employees made contributions under that Scheme. The contributions made by the Association to the fund of this Scheme amounted up to the early part of 1944 to a sum of about £65,000. About February, 1944, a valuation of the Assets and Liabilities of the Superannuation Fund was made and a deficit of actuarial liabilities over assets of £150,000 was disclosed. The Association paid the sum of £150,000 to four persons who are called the Trustees of the Staff Superannuation Fund on February 23, 1944. The Trustees were to stand possessed of the sum paid for the purposes stated in the indenture XI. A draft deed, it is stated, was duly made in terms of the indenture. The Board accepted the position that the payment in question " was made to meet the deficit under the original scheme of actuarial liabilities over assets or, as the Head Office puts it, to ensure solvency on separation of the Trust Fund from the Company's assets "; it did not try to ascertain the real nature of the transaction : on the contrary, it seized upon the words " an initial contribution to the establishment of the Staff Superannuation Trust Fund " and came to the conclusion that by this payment the company was getting rid finally of its pension liabilities, in other words it was bringing into being an asset of enduring benefit to its business. The function of a Tribunal in dealing with a question of this kind is to take all the documents together and give effect to every word in the instruments placed before it, save in so far as the context otherwise requires.

[1] *Associated Portland Cement Manufacturers, Ltd. v. Inland Revenue Commissioners (1946) 1 A. E. R. 68.*

[2] *Bennet v. Underground Electric Railways Co. of London, Ltd. (1923) 2 K. B. 535.*

[3] *British Insulated & Helsby Cables, Ltd. v. Atherton (1926) A. C. 205.*

There was the original fund started by the Association in 1917 (the Staff Superannuation Scheme). In February, 1944, it started the present fund, called the Staff Superannuation Fund, appointed four persons trustees of the fund and paid the sum of £150,000 to the Trustees. It was paid because there was a deficit of actuarial liabilities over assets to this extent. It was an initial contribution to the Trustees of the present fund. It would be inaccurate to say, as the Board does, that the Association was getting rid finally of its pension liabilities. If the Association was bound to pay pensions under the original scheme, it could hardly get rid of its liabilities by establishing a new fund in 1944, but it could provide by this means a method of paying pensions. One cannot separate the past from what was done in 1944. This payment was not made in order to enable the Association to bring into existence a pension fund. The Association had started the fund to pay pensions and if it had paid them year by year, it can hardly be disputed that those payments would be a business expense and those annual sums would be deductible. Provision had been made for the old age of its employees before 1944. There was an existing liability, and the Association in 1944 provided a lump sum in order to prevent annual sums having to be paid later and to be able to fulfil its promises to its employees. If the payment was made to prevent the fund from becoming insolvent, it would be a proper disbursement in arriving at the balance of profits and gains. For as Lord Carson said in *Atherton's* case—" It is not disputed that an annual sum contributed to the pension fund on an actuarial basis for the purposes of making the fund solvent for paying the pensions of the older members of the staff would be a proper deduction in arriving at the balance of profits and gains, it would be an ordinary business expense. Nor, I think, can it be disputed that if at any time the fund threatened to become insolvent after it was started a sum paid to prevent such insolvency would be a proper disbursement in arriving at the balance of profits and gains ". The view of Lord Blanesburgh agrees with this statement of Lord Carson and the reasoning of the Lord Chancellor, Viscount Cave, appears to be in accord with it,—it was because the expenditure was incurred *for bringing into existence* something for the benefit of the trade that it was treated as properly attributable to revenue. The same reasoning ought to apply when a contribution is made to meet a deficit disclosed by a valuation of the assets of the original fund. The payment of this sum would be an ordinary business expense. The answer to the question in this case is : a fair proportion of the sum in question is deductible from the appellant's profits for the year of assessment 1945-1946 as expenses of the head office. The assessment determined by the Board is annulled.

The appellant is entitled to the costs of the appeal to this Court : the fee paid under section 74 (1) should be refunded.

JAYETILEKE S.P.J.—I agree.

Assessment annulled.