

*Privy Council Appeal No. 21 of 1962*

**The Commissioner of Inland Revenue** - - - - - *Appellant*

v.

**A. W. Davith Appuhamy** - - - - - *Respondent*

FROM

**THE SUPREME COURT OF CEYLON**

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JUDGMENT OF THE LORDS OF THE JUDICIAL COMMITTEE  
OF THE PRIVY COUNCIL, DELIVERED THE 12TH NOVEMBER, 1962

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*Present at the Hearing:*

VISCOUNT RADCLIFFE.

LORD EVERSHERD.

LORD JENKINS.

LORD DEVLIN.

MR. L. M. D. DE SILVA.

*[Delivered by VISCOUNT RADCLIFFE]*

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In this appeal the Commissioner of Inland Revenue challenges a judgment and decree of the Supreme Court of Ceylon dated the 10th July, 1961, which allowed to the respondent the deduction of certain expenses in the computation of his income for assessment under the Income Tax Ordinance (c.188).

The respondent was not represented at the hearing before the Board. The point at issue is a short one, and after hearing the argument presented on behalf of the appellant their Lordships are satisfied that the decision of the Supreme Court cannot be sustained.

The facts of the case are very simple and they are found in the case stated by the Board of Review dated the 17th November, 1960, upon which the opinion of the Supreme Court was required. Since the year 1945 the respondent had been interested in a business called The Kandy Ice Co. He seems to have been the owner of it since that year, but at any rate on the 16th August, 1949, a deed of transfer was executed by a Mr. Robert Wilson under which he sold and assigned to the respondent the assets and goodwill of the business.

The business was and remained unincorporated, but after the respondent's purchase some proposal was made as between him and certain other persons to form it into a limited company. The proposal fell through, but litigation followed in which the respondent was sued by some of his associates, their claim being that he had acted in the purchase as agent for a syndicate and that, as members of the syndicate, they were entitled to participate in the profits of the business. This claim was successfully repelled by the respondent, and the litigation ended on the 27th September, 1955, with agreed terms of settlement, under which the respondent was acknowledged to have been as from October, 1945, sole owner of "all the assets movable and immovable, including the goodwill of the business which was and is called and known as 'The Kandy Ice Company,' which forms the subject matter of this action", and the plaintiffs withdrew any claim to any right to or interest in the assets or goodwill of that business. The respondent undertook to pay to the plaintiffs a sum of Rs. 76,500, and it was agreed that each party should bear his own costs to date of the litigation.

Under the Income Tax Ordinance the respondent was assessable to tax upon the profits derived by him from his business, The Kandy Ice Co. In the computation of those profits for the three years ending 31st March, 1953, 31st March, 1954 and 31st March, 1955, he claimed to bring in as admissible expenditure the legal expenses which he had incurred in resisting the claims of the members of the alleged syndicate to share with him in the ownership of the business. Thus for the first year he wished to charge Rs. 3,260 under this head, for the second, Rs. 1,100, and for the third, Rs. 2,695.

The Income Tax Assessor disallowed the claim. There was an appeal to the Authorised Adjudicator appointed by the appellant in accordance with the Ordinance. He upheld the Assessor. There was then an appeal to the Board of Review which accepted the argument of the respondent that the sums in question constituted expenditure incurred "in the production of income" within the meaning of the relevant section of the Ordinance and allowed the appeal. A case was asked for and stated for the opinion of the Supreme Court raising the correct legal questions for their determination. The Court, however, dismissed the appeal without answering the questions or giving their reasons, merely saying that they agreed with the decision of the Board of Review.

In their Lordships' view the questions raised can only be answered in the light of those provisions of the Income Tax Ordinance that provide the rules for assessing income consisting of the profits of a trade or business. The business must, of course, be treated as a distinct "source" of income for this purpose: if it were not, it would not be possible to find the basis upon which to identify the receipts, expenditure and other charges attributable to it. The profit emerging is nothing but the figure of balance that results from setting the expenditure and other charges against the receipts. The business, therefore, must necessarily be treated objectively as a separate entity which has allocated to it certain assets and certain obligations; and this analysis is required in order to ascertain its profits even though there is only a single individual who is its owner or proprietor. If the task of identifying the source and so its profits is approached in this way, it seems a somewhat inconsistent result that expenses incurred by its proprietor over a dispute with other persons as to their respective rights to share in the ownership of the business should be chargeable against the profits of the business itself. None of its assets is threatened by such litigation nor is their profitability in any way affected. As is correctly stated in annexure X.1 to the case stated, which contains the Board of Review's actual Order, "If the plaintiffs had succeeded in this litigation the appellant would have become entitled only to a certain share of the income from the business for the past years and only to a share of the income in the future. The result of the litigation would not have affected the profits earned from The Kandy Ice Co., but it could have seriously diminished the income of the appellant from this source" (see para. 4).

There is no doubt that that finding states the position accurately; but their Lordships think it impossible to say in the light of it that the expenses claimed are permissible deductions under the rules laid down by the Income Tax Ordinance for the ascertainment of profits or income (see Chapter III). By S. 9 it is provided that "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;" and by S. 10 no deduction is to be allowed in respect of "any disbursements or expenses not being money expended for the purpose of producing the income". If, then, these litigation expenses related to an issue whose outcome would not have affected the profits of the business one way or the other but would have affected only the respondent's share as owner of them, how can they be said to have been expended in the production of the profits from this taxable source, so as to satisfy the requirements of Sections 9 and 10?

Words very similar to those used in Sections 9 and 10 have already been under the consideration of the Board in dealing with the Land and Income Tax Act 1916 of New Zealand, see *Ward and Co., Ltd. v. Commissioner of*

*Taxes* [1923] A.C. 145. The rule then in question was expressed in the form that no deduction was to be made in respect of expenditure "not exclusively incurred in the production of the assessable income". In both cases emphasis is thrown upon the criterion that it is the effect of the expenditure in contributing to the income of the designated source that is to be considered. The opinion of the Board, delivered by Lord Cave, held that the disqualification imported by the rule required that allowable expenditure must have been incurred "for the direct purpose of earning profits". This requirement was evidently regarded by them as a highly restrictive one: for it was treated as having the effect of disallowing expenditure intended to influence public opinion against prohibition of intoxicants, a measure which, if introduced, would certainly have had a destructive effect upon the profits of the business of the brewing company, the assessee concerned. Such expenditure though disallowed was related to the maintenance of the business itself, the value of its goodwill and the preservation of its profitability in, at any rate, a recognisable sense. The expenditure in question here has no comparable claim to recognition.

Their Lordships have no wish to assert the principle that the decision in *Ward's* case *supra* lays down a comprehensive rule for deciding all the various cases that may arise with regard to chargeable expenditure, when words such as those found in the New Zealand Act and the Ceylon Ordinance are employed by a legislature. The distinction between expenditure to earn profits and expenditure to avoid losing profits is itself a fine one, and cases may yet arise in which expenditure, though not in a direct or obvious sense creating profits, is yet attributable to the production of them. But this case is not one of them—the expenditure here in question is simply the cost incurred by the owner of an income-producing source in fighting out between himself and others their respective claims to the ownership of that source.

It would not be useful to the determination of this appeal to refer to decisions given in the United Kingdom on questions more or less analogous to this one, because the forms of the respective statutory provisions are not the same and it has been recognised, on the one hand in the *Ward* case, that English authorities are not necessarily applicable to such legislative rules as those enacted in New Zealand, and, on the other hand in the majority decision of the House of Lords in *Morgan v. Tate and Lyle Ltd.* [1955] A.C. 21, that the *Ward* decision does not necessarily apply to cases arising under the United Kingdom system of taxation. It is sufficient to say that their Lordships express no view one way or the other as to whether this case ought to be decided differently if it arose under the latter system.

Their Lordships will humbly advise Her Majesty that the appeal should be allowed; that the decision of the Board of Review dated the 17th November, 1960, and the judgment and decree of the Supreme Court of Ceylon dated the 10th July, 1961, be reversed; that in lieu thereof the following answers should be returned to the questions raised by the case stated by the Board of Review on the 29th September, 1960:—

- (1) No,
- (2) No,
- (3) No,
- (4) Yes,
- (5) No answer required;

and that the respondent should be ordered to pay the costs of the appellant of the hearings before the Board of Review and the Supreme Court.

In the Privy Council

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THE COMMISSIONER OF INLAND REVENUE

v.

A. W. DAVITH APPUHAMY

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DELIVERED BY  
VISCOUNT RADCLIFFE

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