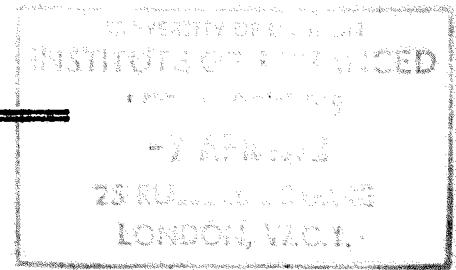


No. 7 of 1971

IN THE PRIVY COUNCIL

O N A P P E A L

FROM THE SUPREME COURT OF CEYLON



B E T W E E N

THE COMMISSIONER OF INLAND
REVENUE OF COLOMBO

Appellant

AND

J. M. RAJARATNAM

Respondent

CASE FOR THE APPELLANT

RECORD

- 10 1. This is an Appeal by leave of the Supreme Court of the Island of Ceylon (hereinafter referred to as "the Supreme Court") from an order of the Supreme Court (Samerawicksame & Weeramantry J.J.) pronounced on 10th December, 1969, whereby the Supreme Court allowed an appeal by the Respondent by way of case stated against an order of the Board of Review constituted under section 75 of the Income Tax Ordinance. By the said order the Board of
- 20 Review dismissed an appeal by the Respondent from a determination of the Deputy Commissioner of Inland Revenue whereby he held that two payments, totalling Rs. 3,000 made by the Respondent in the circumstances hereinafter set out were not annuities within the meaning of section 15 (1) (a) of the Income Tax Ordinance and were, therefore, not permissible deductions in calculating the Respondent's assessable income for the year 1958/59.

- 30 2. The facts material to the question in issue in this appeal were found by the Deputy Commissioners of Inland Revenue and may be

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summarized as follows :-

The Respondent, who had been to England and qualified as a Chartered Accountant, had two brothers who were not so well off financially as he was, and he was under a moral and social obligation to help them. For the year to 31st March 1958, he had a total net income of Rs 25,101.

Ex A1, p.
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On 13th February, 1958, the Respondent executed a Deed of Covenant whereby he covenanted to pay annually to his brother, Mylvaganam Paramananthan during his (the brother's) life, for a period of seven years from the year ending 31 March, 1958, or for the residue of his (the Respondent's) life, whichever was the shorter, the sum of Rs. 1,500. On the same day he executed a precisely similar deed of covenant whereby he covenanted to pay Rs. 1,500 annually to his other brother, Mylvaganam Sathamnantham. 10

Ex A2. p.
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The payments made by the Respondent to his two brothers under the said covenants were disclosed by the brothers in their tax returns and they were duly taxed upon them. The said payments were made out of bounty. 20

3. The question in issue in this appeal is whether upon the facts contained in the Record of Proceedings, and summarized above, the Respondent was entitled in calculating his assessable income for the year 1958/59 to deduct from his total statutory income for the said year the total (Rs. 3,000) of the payments to his brothers made under the said covenants. If on a proper construction of the relevant statutory provisions the said payments were sums payable by way of annuity the Respondent was entitled to deduct the said sum but not otherwise. 30

4. The following statutory provisions are relevant to the question in issue in this appeal. 40

Cap. 242

Income Tax Ordinance

Section 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 -

- 10 (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 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 a like basis;
- 20 (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

5. The Respondent was assessed to Income Tax on an assessable income in the calculation of which the sums paid by him to his brothers under the said covenants had not been deducted from his statutory income.

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The Respondent appealed against the said assessment on the ground that the said payments should have been allowed as deductions from his statutory income in ascertaining his assessable income. The appeal was heard by the Deputy Commissioner of Inland Revenue who held that the said payments were not annuities within the meaning of section 15 (1) (a) of the Income Tax Ordinance.

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6. The Deputy Commissioner of Income Tax gave his determination and reasons on 1st December,

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1966. He referred to the fact that there was a line of decisions in income tax cases in the United Kingdom in which the meaning of the word "annuity" had been considered and, having received the opinions of the English judges in those cases as to the meaning of the word, he reached the conclusion that in the English law of Income Tax the meaning of the word "annuity" imported a transaction by which a person's capital was converted into income. He also concluded that the type of payments known in corresponding English legislation as "annual payments" were not all "annuities".

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The Deputy Commissioner then observed that "in Ceylon only the word 'annuity' occurs in the relevant section. The omission of annual payments in the Ceylon ordinance is significant and is by itself sufficient for the disallowance of annual payments which are not annuities"

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He, thereupon, held that the said payments were not annuities and confirmed the assessment.

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7. On 4th January, 1967, the Respondent appealed to the Board of Review who, having heard the appeal, gave its decision on 23rd June, 1967.

p.11-16

Having observed that the ordinary meaning of the word "annuity" is not free from doubt, and that it is often used to describe any annual payment irrespective of the consideration for the payment, the Board went on to note that the meaning to be given to a word in a statute may differ from its ordinary meaning. The Board considered that the English cases were authority for the proposition that a capital sum received is not an annuity when that sum is paid in annual instalments over a period of time. The Board further considered that the provisions of section 12 of the Income Tax Ordinance (which lays down kinds of expenditure which may not be deducted in computing profits and income from any source) indicated that the word "annuity" where it appears in that section must mean "only income expenditure, the opposite of capital expenditure."

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p.15

The Board considered that the word 'annuity' in Section 15 (1) (a) of the Income Tax Ordinance

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must have the same meaning as it has in section 12. Finally the Board concluded that the payments made by the Respondent were "not attributable to a source of income and therefore did not come within the category of income expenditure", and, therefore, decided that they were not annuities and accordingly dismissed the appeal.

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10 8. On 5th July 1967, the Respondent applied to the Board of Review to state a case for the opinion of the Supreme Court under the provisions of section 74 of the Income Tax Ordinance. A case was duly stated and the appeal came before the Supreme Court (Samerawickrame & Weeramantry J.J.) The judgment of the Supreme Court was given on 10th December, 1969, by Samerawickrame J. (Weeramantry J. agreeing).

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20 9. The learned judge began by setting out the definition of "annuity" given in the Oxford English Dictionary, and then referred to the argument of the Deputy Solicitor-General that "annuity" had come, in the context of Income Tax, to have the definite meaning of an income purchased with a sum of money and he referred to Foley (Lady) v. Fletcher (1858) 3 H. & N. 769. He also quoted Simon's Income Tax (1964-65) Vol.2 at p.751 where it is pointed out that in English law an "annuity" will always be an annual payment but not every annual payment is an annuity, and that it is rarely of great materiality whether an annual payment is described as an "annuity" or otherwise. The learned judge commented that the distinction was of little importance in English law because, in England, Case III taxes both "any annuity or other annual payment", but that in South Africa where the word "annuity" appears by itself in the relevant provision the meaning of the word has not been limited to an annuity purchased for a sum of money. The learned judge cited a passage from Silke on South African Income Tax (3rd edition) at p.63 in support of this proposition.

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The learned Judge then considered the

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p. 23 argument of the Deputy Solicitor-General that in the Income Tax Ordinance the word 'annuity' appears with the words "ground rent" and "royalty" and that, because the latter words imply a quid pro quo, therefore 'annuity' too must be restricted to an annuity purchased for consideration. The learned judge thought that the principle noscitur a sociis could not be applied to interpret this phrase in the light of the ratio decidendi of Inland Revenue Commissioners v. National Book League (1957) Ch. 488. 10

p. 23 The learned judge then referred to other definitions of "annuity" in Stroud's Judicial Dictionary and Wharton's Law Lexicon and concluded that in his view "annuity" in the Income Tax Ordinance is not limited to an annuity purchased with a sum of money but extends to other annual payments.

p. 24 10. The learned Judge then observed that payments to be payments under an "annuity" must not be annual instalments of a capital sum, and that they must have the necessary quality of recurrence and be pure income or profit of the payee, and be made under a legal obligation. 20

p. 25 The learned Judge did not (save by implication in his decision) express an opinion as to whether the payments made by the Respondent represented annual instalments of a capital sum. He did, however, consider whether the payments were made under a legal obligation and reached the conclusion that they were, basing his opinion on the provision of Ceylon law that a promise or agreement to pay money is binding if it is accepted, and on the fact that in this case the Respondent's brothers had accepted the Respondent's promise to pay. 30

The learned Judge thus concluded that the payments made by the Respondent satisfied the characteristics of an annuity and that the claimed deduction of the sums paid under the covenants by the Respondent should have been allowed in ascertaining the Respondents' assessable income. 40

11. On 9th February, 1970, the Appellant was granted conditional leave to appeal to the Privy Council by the Supreme Court; and on 3rd May, 1970, he was granted final leave to appeal to the Privy Council by the Supreme Court

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10 12. The Appellant respectfully submits that the Learned Judges of the Supreme Court were wrong in holding that the payments made by the Respondent to his brothers were annuities within the meaning of section 15 (1) (a) of the Income Tax Ordinance.

20 In the provisions of the English law relating to income tax which correspond to the provisions of the Income Tax Ordinance it is plain that an annuity is a particular type of annual payment. Its special nature was explained by Baron Watson in Foley (Lady) v. Fletcher (1858) 3 H. & N. 769 when he said "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".

30 This definition of the nature of an annuity has been accepted by the Courts in England in a considerable number of cases stretching over a long period. The Appellant will submit that where the word is used in a taxing statute of a commonwealth country which is modelled on English Income Tax Law, it should be given the same meaning unless there is anything in the relevant Commonwealth legislation to indicate that such a meaning was not intended. It is respectfully submitted that there is nothing in the provisions of the Income Tax Ordinance which suggests that any other meaning was intended. Indeed it is respectfully submitted that the association of the word "annuity" with the words "rentcharge" and "royalty" (which both contemplate payment for a consideration) points
40 the other way.

The effect of the judgment of the learned judges of the Supreme Court is to give to the word "annuity" in Section 15 (1) (a) of the Income Tax Ordinance the same meaning as is given in English law to "annual payment" where this word appears in the corresponding English

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legislation. That this is so was made clear when Samerawickrame J. set out the five characteristics of an "annuity". The five characteristics set out are, it is submitted, the characteristics of all annual payments within the meaning of the corresponding English legislation, and thus comprehend a wider class than is covered by the word "annuity" as interpreted and understood in English income tax law.

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If the draftsman of the Income Tax Ordinance had intended that legislation to have the effect that has been given to it by the Supreme Court he would not, it is submitted have used the word "annuity" where it appears in Section 15 (1) (a) but would have used the words "annual payments".

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In the Appellant's view the Deputy Commissioner for Income Tax put the point succinctly when he said "the omission of annual payments in the Ceylon ordinance is significant and is by itself sufficient for the disallowance of annual payments which are not annuities".

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13. If the Appellant's interpretation of the word "annuity" hereinbefore set out is wrong and the word on the true construction of section 15 (1) (a) has the wider meaning given to it by the Supreme Court, the Appellant will contend that, on the facts of this case, the payments made by the Respondent were not deductible from his statutory income as payments by way of annuity because they lacked the necessary quality of all annual payments that they should be income payments by the payer, and that the reason given by the Board of Review for holding that the payments were not deductible was correct.

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The Supreme Court did not in its judgment deal with this point

14. The Appellant humbly submits that the decision of the Supreme Court should be reversed and the decision of the Board of Review should be restored and the deduction of the amount of

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the Respondent's payments from his statutory income for the year 1958/59 should be disallowed for the following (among other)

R E A S O N S

1. THAT upon the true construction of Section 15 (1) (a) of the Income Tax Ordinance the word "annuity" is limited in its meaning to payments which represent an income (of the payee) purchased with a sum of money and the payee's capital has to that extent ceased to exist, the principal having been converted into an income.
2. THAT the said construction is borne out by the association in Section 15 (1) (a) of the Income Tax Ordinance of the words "ground rent" and "royalty" with the word "annuity".
3. THAT the Supreme Court was wrong to give to the word "annuity" a meaning so wide that it covered all payments which would in English law be annual payments regardless of whether they were annuities.
4. THAT the payments made by the Respondent under the covenants were not income payments by the Respondent.
5. THAT the decisions of the Deputy Commissioner of Inland Revenue and of the Board of Review were correct and should be restored.

PATRICK MEDD

IN THE PRIVY COUNCIL

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B E T W E E N

THE COMMISSIONER OF INLAND
REVENUE OF COLOMBO Appellant

AND

J. M. RAJARATNAM Respondent

CASE FOR THE APPELLANT

HATCHETT JONES & CO.
90 Fenchurch St.
London E.C.3.