1956 *Present :* Basnayake, C.J., and Gunasekara, J.

COMMISSIONER OF INCOME TAX, Appellant, *and* THE GLASGOW ESTATE CO., LTD., Respondent

*S. C. 5—Income Tax Case stated BRA/PT 4*

*Income tax—Profits Tax Act, No. 5 of 1948—Section 9—"Capital employed in the business".*

Where a limited company engaged in producing tea retained in the form of cash the equivalent of the amounts that were likely to be needed for the payment of (*a*) the income tax that would shortly fall due and (*b*) dividends that would shortly be declared—

*Held,* that the sum of money so retained was "capital employed in the business" within the meaning of section 9 of the Profits Tax Act, No. 5 of 1948.

CASE stated under section 74 of the Income Tax Ordinance (Cap. 188) read with section 14 of the Profits Tax Act, No. 5 of 1948.

*M. Tiruchelvam,* Deputy Solicitor-General, with *A. Mahendrarajah,* Crown Counsel, and *I. F. B. Wickremanayake,* Crown Counsel, for the appellant.

*H. V. Perera, Q.C.,* with *S. Ambalavanar,* for the respondent.

*Cur. adv. vult.*

October 26, 1956. GUNASEKARA, J.—

This is an appeal by the Commissioner of Income Tax by way of a Case Stated under section 74 of the Income Tax Ordinance (Cap. 188) read with section 14 of the Profits Tax Act, No. 5 of 1948. Section 9 of the latter enactment provides that the chargeable surplus of profits or income of any person for each profits tax year shall be ascertained by deducting from the taxable profits or income of that person for that year an allowance equal to the larger of the two following amounts :—

(*a*) an amount equal to six per centum of the capital employed in the business of that person at the commencement of the accounting period of which the profits are assessed to tax in that year, or

(*b*) an amount of fifty thousand rupees.

The main question that arises upon the appeal is the meaning of the expression "capital employed in the business" that is used in this section.

The respondent is a limited company engaged in producing tea. In an appeal to the Commissioner of Income Tax against an assessment to profits tax for the year 1951 it claimed that an item of cash amounting

to Rs. 475,162 should have been included in the computation of the capital employed in its business at the commencement of that year. This item, according to the company's balance sheet for 1950, was made up as follows :—

| | *Rs.* | *c.* |
|---|---|---|
| National Bank of India, Ltd.— | | |
| Current Account .. .. | 468,258 | 55 |
| Dividend Account .. | 5,137 | 35 |
| Estate Current Account .. | 1,624 | 62 |
| Cash on Estate .. .. | 141 | 30 |
| | 475,161 | 82 |

The assessor had reduced the amount to Rs. 375,162, on the ground that that was "a reasonable estimate of the amount of cash used by the company for the purpose of the business". Upon a reference back to the assessor the question was discussed between an assistant commissioner and the company, and the former offered to fix the amount at Rs. 320,000. At the hearing of the appeal before the commissioner the assessor contended that the amount must be further reduced by a sum of Rs. 140,632, made up as follows :—

| | *Rs.* |
|---|---|
| Net dividend paid in respect of 1950 .. | 73,125 |
| Income tax for 1951–1952 .. .. | 67,507 |
| | 140,632 |

The commissioner agreed with this contention and fixed the amount of the cash to be included in the computation of the capital employed in the business at Rs. 180,000. Upon an appeal by the company the Board of Review increased the amount by Rs. 190,000. The commissioner had included in the sum fixed by him a sum of Rs. 120,000 as the equivalent of 2 months' estate expenditure, which he held would be sufficient for the current requirements of the business. The Board increased this sum by Rs. 50,000, on the ground that "a prudent Tea Estate Co. would keep more than 2 months' costs of upkeep in ready cash, because unforeseeable contingencies like a slump, strike accompanied by violence or an unusual pestilence, may suddenly demand abnormal expenditure". They held that they should allow under this head the equivalent of the "costs of upkeep" for 3 months, which they estimated at Rs. 170,000. They also held that "it was plainly necessary for the appellant company to have in deposit on 1.1.1951 the cash required (1) to pay the income tax which would shortly fall due, i.e. 67,507, (2) the dividend of 73,125", and that the commissioner "was wrong in reducing the capital employed by the amount of those two items".

The questions of law that are said to arise for decision upon this appeal are formulated in the stated case as follows :—

"(1) Can the monies held in deposit (*a*) for the payment of Income Tax which will fall due and (*b*) for the payment of dividends, amount in law to capital employed in the business of the Glasgow Estates Co., Ltd., for the accounting period in question ?

(2) Were the Board of Review justified in holding, in the absence of evidence, that three months cost of upkeep be held as working expenses in place of the two months cost fixed by the Commissioner ? "

At the commencement of the chargeable accounting period, that is to say on the 1st January, 1951, the income tax for 1951–1952 had not been assessed and the dividend in question had not been declared. The Board took the view that "the company was well advised to have cash in hand to meet those claims" and that therefore the cash that was necessary for the purpose must be taken to have been capital employed in the business. It is contended for the Crown that tax and dividends must be paid out of profits and that therefore the sum of Rs. 140,000 cannot be treated as capital. It is also contended that in any event cash that was reserved for these payments was money that was to be paid out and not money that was to be employed in the business.

On the question of the meaning of "capital employed in the business" the learned Deputy Solicitor-General cited, among other cases, those of *Liberty & Co., Ltd. v. The Commissioners of Inland Revenue*[1] and *James Waldie & Sons, Ltd. v. The Commissioners of Inland Revenue*[2]. The question that was considered in each of these cases was whether certain sums forming part of the capital employed in a business were also investments and should therefore be excluded in the computation of the amount of the capital employed in the business for the purposes of Excess Profits Duty under certain provisions of the Finance (No. 2) Act, 1915. The sums in question in the former case were held to be investments and in the latter not. The question whether they were investments arose, however, only upon the assumption that they formed part of the "capital employed in the business". These cases, therefore, throw no light on the question whether this expression means anything more than the "capital of the business". The same comment may be made on the case of *Inland Revenue Commissioners v. Laurence Philipps & Co. (Insurance), Ltd.*[3], which too is relied on by the learned Deputy Solicitor-General. The question there was whether certain loans were investments and should therefore be left out of account, as provided in Schedule VII to the Finance (No. 2) Act, 1939, in the computation of the capital employed in a business in the relevant period.

It is contended for the Crown that the expression means capital that "is actually earning profits" and does not include capital in the form of cash lying idle in the bank. The learned Deputy Solicitor-General

[1] *(1924) 12 T. C. 630.* [2] *(1919) 12 T. C. 113.*

[3] *[1941] 2 All E. R. 144.*

cited in support of this contention an observation made by Lord Greene M. R., in *Northern Aluminium Co., Ltd. v. Inland Revenue Commissioners*[1], as to the meaning of " capital employed in the trade or business in any chargeable accounting period " in the proviso to section 13 (3) of the Finance (No. 2) Act, 1939. But the distinction drawn there is not between capital actually earning profits and capital lying idle, but between capital actually earning profits in the relevant period and " notional and artificial capital which had no real existence " during that period. What Lord Greene said was :

> " That (i.e. ' capital employed ') seems to me quite clearly to refer to capital actually employed, not to some item which is artificially going to be written back into the capital in some future year, but capital which is in fact being employed for the purpose of earning profits. You earn profits with real capital, not with something which, on a subsequent re-opening of the account, is going artificially to be attributed to a particular period. "

The question whether there is any distinction that can be drawn between one part of the capital of a business as being employed in the business and another as not being so employed did not arise for consideration. The learned judge was only concerned to point out that the capital provisions of the Act " are dealing with realities, things which are really assets and really liabilities, and not with something which is for profit purposes (which is quite a different conception) to be artificially regarded as a liability to be written back into the accounting period ".

It was pointed out in the case of *Laurence Philipps & Co. (Insurance), Ltd.*[2] that " there is never any difficulty about regarding money lying idle in the bank as money employed in the business providing there is a reasonable probability of it being wanted in the accounting year or in a short space of time thereafter ". The qualification that there must be such a reasonable probability was necessary in view of a provision in the Finance (No. 2) Act, 1939, Schedule VII, Part II, para. 3 that " any moneys not required for the purposes of the trade or business " shall be left out of account in the computation of the capital employed in the trade or business in any chargeable accounting period. Our Profits Tax Act, No. 5 of 1948, contains no such provision, although there was a similar provision in section 10 (5) of the Excess Profits Duty Ordinance, No. 38 of 1941, as amended by Ordinance No. 6 of 1942. Under our law, therefore, there is no ground for limiting to an amount that will probably be " wanted in the accounting year or in a short space of time thereafter " the amount of any cash in the bank that can be regarded as employed in the business, but the entirety of such an asset must be regarded as being so employed inasmuch as it is available for any purpose of the business.

The case of *Birmingham Small Arms Co., Ltd. v. Inland Revenue Commissioners*[3] was cited by the learned counsel for the Crown. The question that arose for decision there was whether a right of claim to compensation for war damage, under the War Damage Act, 1941, was

[1] *[1946] 1 All E. R. 516 at 559, 552.* [2] *[1947] 2 All E. R. 144.*
[3] *[1951] 2 All E. R. 296.*

an asset the value of which, during a chargeable accounting period, formed part of the capital employed in the trade or business of the appellant company, within the meaning of the Finance (No. 2) Act, 1939, Schedule VII, Part II, paragraph 1 (1); which provides for the valuation of various kinds of assets in the computation of "the amount of the capital employed in a trade or business (so far as it does not consist of money)". When the company was assessed to excess profits tax for the period 1st August 1940 to 31st July 1941 no account was taken of this claim in the computation of the amount of the capital employed in their trade or business. The company appealed against the assessment, contending that the right of claim, which was in respect of damage caused before the 31st May 1941, became an asset of the trade or business on that day upon the coming into force of Regulations under the War Damage Act. The appeal was dismissed by the Commissioners for the Special Purposes of the Income Tax Acts, who held that the claim, regarded as an asset, did not appear to them to be employed in the trade. An appeal from their determination to the King's Bench Division was dismissed, and further appeals taken successively to the Court of Appeal and the House of Lords were also dismissed. The appeal to the House of Lords was heard by Lord Simonds, Lord Normand, Lord Oaksey, Lord Radcliffe and Lord Tucker. The ground upon which Lord Simonds based his conclusion was that a right which is assumed to be an asset belonging to a limited company "cannot be capital employed in its trade unless it is an asset so employed", and that he saw no reason for disturbing the finding of the commissioners who had determined as a fact that the right in question had not been so employed; Lord Normand, Lord Radcliffe and Lord Tucker were of the view that the dismissal of the appeal should be based on a different ground, that the right was not an asset of the kind contemplated by the relevant provision of the Finance (No. 2) Act, 1939; and Lord Oaksey said that he was not prepared to dissent from the conclusions at which the rest of their Lordships had arrived.

The opinion of Lord Simonds is relied upon by the learned Deputy Solicitor-General as supporting a view that an asset can form part of the capital employed in a trade or business only if it "is actually earning profits" or is "actively" employed in the trade or business. I am unable to agree that support for this view can be found in that opinion. Having pointed out that the right in question "consisted of a right, subject to proof which might be difficult, to an indeterminate sum payable at a future and uncertain date", and that that was the position during the two months of the relevant accounting period with which alone the appeal was concerned, Lord Simonds formulated as follows the question that arose:

> "The question, then, is what was the average amount of capital employed by the trade or business of the appellants during the accounting period, or, more precisely, was it right, in order to bring up that average, to include at any, and what, figure the value of the right to which I have referred for the last two months of the period?"

Discussing the answer to this question, he rejected a contention that "every asset of a trade or business is part of the capital employed in the trade or business unless expressly excepted by statute", and that therefore the commissioners must be held to have misinterpreted the word "employed"; but he did not hold that an asset is not "employed in a trade or business" unless it was "actually earning profits" or was "actively employed". On the other hand, the opinions of Lord Normand, Lord Radcliffe and Lord Tucker definitely negative such a view. Lord Normand held that "para. 1 (1) of Part II of sched. VII to the Finance (No. 2) Act, 1939, does not call for an inquiry whether an asset (within the meaning of the paragraph) was 'actively' employed in the company's trade or business in the relevant year"; Lord Radcliffe that he did not think that the words "capital employed in a trade or business" bore any significant difference of meaning from the words "capital of a trade or business"; and Lord Tucker that "the words 'capital employed' . . . . . do not refer to the actual use made of a particular asset in the relevant accounting period once it is shown to have been a form of capital put into the business and still there".

I do not think there can be any question that the Board of Review were right in regarding the item of cash with which the present case is concerned as being "a form of capital put into the business and still there". A decision by the company to retain in the form of cash the equivalent of the amounts that were likely to be needed for the payment of the income tax that would shortly fall due and dividends that would shortly be declared would not be a withdrawal of that amount of cash from the capital or even an earmarking of any money for these purposes; for the sum so retained in the form of cash would continue to be available for any purpose of the business. I am therefore unable to accept the contention that the sum of Rs. 140,000, which the commissioner regarded as representing the amount needed for the payment of the income tax for 1951–1952 and the dividend declared in 1951, cannot be treated as capital.

In my opinion there is no ground for limiting to what is required for the purposes of a trade or business the amount of cash that can be regarded as capital employed in it. But assuming that it was necessary in this case to determine what sum the appellant company needed to have available in cash for working expenses, I am unable to agree that the Board determined this question without evidence when it held that a reasonable sum would be the equivalent of the cost of upkeep for 3 months rather than 2 months. The Board had before it sufficient material in the form of evidence as to the nature and extent of the business done by the company.

The appeal must be dismissed with costs.

BASNAYAKE, C.J.—

I have had the advantage of reading the Judgment prepared by my brother Gunasekara with which I agree.

The Board of Review has held as a question of fact that there was a reasonable probability of a sum of Rs. 370,000 out of the money in the cash account of the Company being required by the assessee for his business. That is a finding of fact which falls within the province of the Board and is final under our Income Tax Ordinance.

The statement of Atkinson J. in the *Acme Flooring Co.* case [1] in regard to the manner in which this question of the capital employed in a business should be approached appeals to me and I quote his words :—

> "A man could not be allowed to retain very, very large sums of money where the possibilities of their being required were so unlikely or so remote that no reasonable man would retain the money lying idle in order to meet such vague possibilities. I imagine (the Special Commissioners) have to ask themselves this question : 'What would a reasonable business man regard as sufficient money to retain lying idle to meet his future commitments—certainly the commitments in the near future ?' The Commissioners say : 'We accept that.' I think they have said : 'We go beyond that' but we do not think that he ought to be allowed to look too far ahead.' To my mind, where the line is to be drawn is obviously a question of fact. I cannot interfere merely because I think I would have drawn the line somewhere more favourable to the trader. It is for the Commissioners to say."

In the later case of *Inland Revenue Commissioners v. Laurence Philipps & Co.* [2] the same Judge said :

> "There is never any difficulty about regarding money lying idle in the bank as money employed in the business providing there is a reasonable probability of it being wanted in the accounting year or in a short space of time thereafter."

The view that it is the function of the Special Commissioners to determine as a fact whether an asset belonging to a Company is an asset employed in its trade has never been doubted. It was re-asserted in the *Birmingham Small Arms* case [3]. Though the questions stated by the Board for the opinion of this Court have been answered they are strictly not questions of law which arise on the stated case.

*Appeal dismissed.*

[1] *1943 (1) All E. R. 546.* [2] *1947 (2) All E. R. 141.*
[3] *1951 (2) All E. R. 296.*