

1969 Present : Samerawickrame, J., and Weeramantry, J.

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

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

*Income Tax Ordinance (Cap. 242)—Section 15 (1) (a)—Meaning of term “annuity”—  
Agreement of a voluntary nature to pay money annually—Payments made  
annually thereunder—Right of payer to deduct them from his statutory  
income.”*

An “annuity” in section 15 (1) (a) of the Income Tax Ordinance is not limited to an annuity purchased with a sum of money but extends to other annual payments.

By each of two agreements or deeds of covenant executed by him in favour of two of his brothers, the assessee-appellant undertook voluntarily that for a period of seven years or during the residue of his life, whichever should be shorter, he would pay annually to each brother named therein during his life the sum of Rs. 1,500. The covenants or agreements were accepted by the two brothers and certain payments made thereunder were declared by them as part of their income in their income tax returns.

*Held*, that the two sums of Rs. 1,500 paid by the assessee-appellant to his brothers in terms of the agreements were annuities and, therefore, deductible under section 15 (1) (a) of the Income Tax Ordinance in ascertaining his assessable income for the year of assessment 1958/59.

“ For a payment to be an annuity it must—

- (1) be made with reference to a year though it may be paid in periodic instalments, e.g., quarterly or monthly,
- (2) not be a receipt or accrual of a capital nature to the payee,
- (3) be made under a legal obligation,
- (4) be either recurrent or capable of recurrence,
- (5) be pure income or profit of the payee ”.

**C**ASE stated for the opinion of the Supreme Court under s. 74 of the Income Tax Ordinance (Cap. 242).

*S. Ambalavanar, with M. Radhakrishnan, for the assessee-appellant.*

*H. Deheragoda, Senior Crown Counsel (now Deputy Solicitor-General), with P. Naguleswaran, Crown Counsel, for the assessor-respondent.*

*Cur. adv. vult.*

December 10, 1969. SAMERAWICKRAME, J.—

The appellant executed two agreements or deeds of covenant in favour of two of his brothers. By each agreement the appellant undertook that for a period of seven years or during the residue of his life whichever period should be shorter he would pay annually to the brother named therein during his life the sum of Rs. 1,500. The two sums of Rs. 1,500 were paid to his brothers and they have been returned by them and included in the assessments made on them for income tax. The appellant claimed that the two sums paid to his brothers were annuities payable by him and were deductible under Section 15 (1) (a) of the Income Tax Ordinance in ascertaining his assessable income for the year of assessment 1958/59.

The assessor disallowed deduction of the two sums and assessed the assessable income of the assessee at Rs. 28,101. An appeal was made to the Commissioner against the assessment and the Deputy Commissioner who heard the appeal confirmed the assessment. On an appeal to it the Board of Review held that the appellant was not entitled to a deduction of the two sums paid by him to his two brothers. On an application by the appellant the Board has stated a case for the opinion of this Court on the following :—

- (a) are the two sums of Rs. 1,500 paid by the assessee to his two brothers annuities payable by him,
- (b) are the two sums of Rs. 1,500 paid by the assessee to his two brothers deductible under s. 15 (1) (a) of the Income Tax Ordinance.

There is no definition of annuity in the Ordinance. The Oxford English Dictionary gives the following meanings :—

“ (1) A yearly grant, allowance, or income.

(2) The grant of an annual sum of money, for a term of years, for life, or in perpetuity ; which differs from a rent charge in being primarily chargeable upon the grantor's person, and his heirs if named, not upon specific land.



- (3) An investment of money, whereby the investor becomes entitled to receive a series of equal annual payments, which, except in the case of perpetual annuities, includes the ultimate return of both principal and interest; also, the annual (or, for convenience, quarterly) payment thus made.”

The learned Deputy Solicitor-General submitted that, in the context of Income Tax, annuity had come to have the definite meaning of an income purchased with a sum of money and relied on *Foley (Lady) v. Fletcher*<sup>1</sup>. Simon's Income Tax (1964-65) Vol. 2, page 737 states:—

“An annuity will of necessity always be an annual payment but not every annual payment is an annuity. In *Foley (Lady) v. Fletcher* (supra), Watson B. gave the following definition of one kind of annuity:— An annuity means where an income is purchased with a sum of money, and the capital has gone and ceased to exist, the principal having been converted into an annuity. ‘Annuity’ is generally used to describe annual sums of fixed amounts payable to individuals but whether an annual payment is described as an ‘annuity’ or otherwise is rarely of great materiality in considering the application of Case III.”

The provision in Case III contains “any annuity or other annual payment...” Hence the distinction between annuity and annual payment is of little importance in English Income Tax Law. But in South Africa where the word “annuity” appears by itself in the relevant provision it has not been limited to an annuity purchased for a sum of money. Silke on South African Income Tax (3rd edition) at page 63 states:—“In *Foley v. Fletcher* it was held that ‘an annuity means where an income is purchased with a sum of money and the capital has gone and ceased to exist, the principal having been converted into an annuity’. Whereas this definition meets the case of the ordinary type of annuity purchased from an insurance company, it does not cover all cases since an annuity may also be granted by way of donation or inheritance without being purchased, in which event the conversion of capital into an annuity does not arise”.

The learned Deputy Solicitor-General further submitted that in the Ordinance “annuity” is coupled with “ground rent or royalty” and that as these terms imply a *quid pro quo* annuity too must be restricted to an annuity purchased for consideration. Payment of ground rent or royalty is made for a benefit or consideration which continues to be received from the payee. A countervailing benefit to the payer or the stipulation by him for future benefit of any kind precludes a payment being considered an annuity—vide *I. R. Commissioners v. National Book League*<sup>2</sup>. The principle *noscitur a sociis* is, therefore, not appropriate for application to the interpretation of the provisions in question.

<sup>1</sup> (1858) 3 H. & N. 769.

<sup>2</sup> (1957) Ch. 488.



Stroud has the following quotation, "An annuity is a yearly payment of a certain sum of money granted to another in fee, for life or years, charging the person of the grantor only (Co. Litt. 141b)". Wharton's Law Lexicon has, "an annuity is a fixed sum payable annually either in perpetuity or for any less period".

I am of the view that "annuity" in the Income Tax Ordinance is not limited to an annuity purchased with a sum of money but extends to other annual payments. I am fortified in my view by the fact that in *Law Society v. The Commissioner of Income Tax*<sup>1</sup>, it was held that the annual grant of Rs. 50,000 received by the Incorporated Law Society from the Government in terms of a statute was an annuity.

Definitions of annuity set out above refer to fixed sums payable annually. Under the agreements entered into by the appellant the fixed sum of Rs. 1,500 is payable to each brother. It is, therefore, unnecessary to consider what the position would be if there is an obligation to make a payment annually but the amount of the payment varies from year to year. There is authority that fluctuating sums may nevertheless be annual payments within the provision in the English Act—vide *I. R. Commissioners v. London Corporation*<sup>2</sup>.

The payments must not be annual instalments of a capital sum such as an antecedent debt or the consideration for purchase of property. In *The Commissioner of Inland Revenue v. Silva*<sup>3</sup>, it was held that monthly sums stipulated for in an agreement were in reality part of the purchase price of a business and therefore constituted payments of a capital nature and not payment by way of annuity. In *Commissioner of Income Tax v. Nilgiriya*<sup>4</sup>, it was held that the payments were in effect instalments of a fixed gross sum that was due.

There must be a legal obligation to make the payments. Voluntary payments even though made regularly are not annuities but gifts.

It is of the essence of an annuity that it has the quality of recurrence. Accordingly an annual payment to be an annuity it must either be recurrent or capable of recurrence. In *Asher v. London Film Productions Ltd.*<sup>5</sup>, Lord Greene M. R. said:—

"The payments are annual payments in the sense that they have that recurrent quality which is the distinguishing mark differentiating an income from a capital payment for these purposes. You can have an annual payment under this rule, even though it happens by some accident or other to fall due in one year only. The question is, has it the necessary periodical or recurrent quality?"

It would appear that a single payment made on a covenant for a period of years or for the life of the covenantor whichever is shorter, would be an annuity even where the covenantor died after one payment had become due and had been paid.

<sup>1</sup> (1954) 56 N. L. R. 97.

<sup>2</sup> (1953) 1 A. E. R. 1075.

<sup>3</sup> (1961) 64 N. L. R. 65.

<sup>4</sup> (1960) 63 N. L. R. 176.

<sup>5</sup> (1944) 1 A. E. R. 77 at 80.



The amount paid must be pure income or profit of the payee—vide *In re Hanbury, Coniskey v. Hanbury*.<sup>1</sup> It would appear that there are a number of payments, without doubt annual, the nature and quality of which make it impossible to treat them as the pure income or profit of the recipient. An example given is that of a yearly payment made to the proprietor of a garage for the hire of a motor car. The very nature of the payment itself having regard to the circumstances in which it is made necessarily makes the sum paid in the hand of the recipient an element only in the ascertainment of his profits. Thus a yearly payment made to a tradesman for supplies or services, though it possesses all the other characteristics required, would not be an annuity. In *I. R. Commissioners v. National Book League* (supra), it was held that certain payments received by a charity under covenant in respect of which the covenantor received certain benefits were not pure income of the charity as the benefits received by the covenantors were such that it could not be said that the payments were made without conditions or counter stipulations. Simon's Income Tax (1964-65) Vol. 2, page 744 states :—

“ There must it seems be a countervailing benefit in respect of each annual payment (which otherwise qualifies as such) to prevent that payment being ‘pure income profit’ of the recipient; equally a trading receipt will not satisfy the test as the references to *In re Hanbury*, ante, demonstrate; nor will any payment which is of a kind against which the expense of earning it may properly be set in order to ascertain the taxable income therefrom.”

From what I have stated above it would follow that for a payment to be an annuity it must—

- (1) be made with reference to a year though it may be paid in periodic instalments, e.g., quarterly or monthly,
- (2) not be a receipt or accrual of a capital nature to the payee,
- (3) be made under a legal obligation,
- (4) be either recurrent or capable of recurrence,
- (5) be pure income or profit of the payee.

It has not been necessary for the purpose of this case to decide whether the sum paid yearly must be fixed or may vary from year to year.

The learned Deputy Solicitor-General submitted that under our law a duty to maintain is not limited to a man in respect of his wife or child but that in certain circumstances a child is under an obligation to maintain a parent or a brother another brother and that the payments made by the appellant to his brothers were made in pursuance of an obligation under our law to maintain them and not by reason of the covenants he had entered into. Assuming that in certain circumstances a duty may arise upon a person to maintain his brother that duty would only arise



where the brother is in indigent circumstances of a kind in which the law gives him the right to claim maintenance. There is no evidence in this case that the brothers of the appellant were in such indigent circumstances that there was in law an obligation on the appellant to maintain them. As the basis of fact upon which the learned Deputy Solicitor General based his argument does not exist it is unnecessary to consider further what might have been the position had such a basis of fact been shown.

He further submitted that the appellant was in effect making a gift to each of his brothers of a sum of Rs. 10,500 in yearly instalments of Rs. 1,500 and that the payments would accordingly not constitute annuities. There is no material to show that there was an antecedent fixed sum of Rs. 10,500 which was to be liquidated or paid in the manner provided for in the agreement. The agreement itself stipulated that payments were to be made for a period of seven years or during the residue of the appellant's life whichever period should be shorter. It also provided that the payments were to be during the lifetime of the brother. In view of the nature of the provision in the agreement it is not possible to take the view that it provided for the payment of a lump sum of Rs. 10,500 in annual instalments of Rs. 1,500.

The submission also raises the question as to whether payments were voluntary. The act of the appellant in entering into the agreement or covenant was no doubt voluntary in the sense that he was a free agent and could have abstained from entering into it if he wished but once he had executed the agreement the payments under it were not voluntary if the agreement was a binding agreement. In that case there would be a legal contractual obligation on him to make the payments stipulated for in the agreement—vide *I. R. Commissioners v. Peters*<sup>1</sup>. Under our law a promise or agreement to pay money is binding if it has been accepted—vide *Public Trustee v. Udurawana*.<sup>2</sup> The covenants or agreements entered into by the appellant had been accepted and money due under them had been paid to his brothers and had been declared by them as part of their income in returns made for purposes of income tax. I am, therefore, of the view that the payments made by the appellant in terms of the covenants were not voluntary but were made under a legal obligation.

The amounts of the annuities claimed as deductible by the appellant was a sum of Rs. 3,000 as against his income of Rs. 28,101 which is a little over ten per cent. It is unnecessary to decide in this case, and I reserve for a decision in an appropriate case when the question does arise whether payments of sums amounting to a much larger proportion of a person's income may be claimed as deductions on the basis of payment by way of annuity.

<sup>1</sup> (1941) 2 A. E. R. 620.

<sup>2</sup> (1919) 51 N. L. R. 193.

I am of the view that the payments made by the appellant satisfy the characteristics of an annuity and that his claim for deduction of them from his statutory income in ascertaining his assessable income should have been allowed. I accordingly answer the two matters raised in the Case Stated :—

- (a) The two sums of Rs. 1,500 paid by the assessee to his two brothers were annuities payable by him,
- (b) The two sums of Rs. 1,500 paid by the assessee to his two brothers are deductible under s. 15 (1) (a) of the Income Tax Ordinance.

The respondent must pay the appellant costs fixed at Rs. 262.50. The appellant will also be entitled to a refund of the sum of Rs. 50 paid under s. 78 (1).

WEERAMANTRY, J.—I agree.

*Appeal allowed.*

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