NEW PORTMAN LTD.
V.
JAYAWARDENA AND TWO OTHERS

COURT OF APPEAL
TAMBIAH, J.
MOONEMALLE, J.
C. A. APPLICATION 2366/80
C. A. APPLICATION 2367/80
FEBRUARY 22 AND 23 1984.

Certiorari — Prohibition — Income tax — Assessment — Reasons — Adequacy of the reasons — Assessor acting on information — Duty to confront assessees —Section 115 (3) of the Inland Revenue Act.

New Portman Ltd. furnished a return (P1) of its income for the year of income 1979/80 to the 2nd respondent.

It disclosed a total statutory income of Rs. 42,210/- and a loss of Rs. 197,574/- allowable loss under S. 162 (b) (iv) of the Inland Revenue Act No. 28 of 1979.

It was brought forward from the previous year of assessment.

The Inland Revenue department rejected the return and assessed the income at Rs. 150,000/- against a statutory loss of Rs. 155,164/-.

The petitioner moved for on certiorari and prohibition against the assessment.

Held

(1) The reasons for rejection of the return given by the Assesor to the assessee should be adequate and intelligible. General reasons are inadequate.

(2) The assessor, if acting on information, must confront the assessee with the information or its substance and give him an opportunity to counter the information.

Cases referred to:

1. *Mrs. Fernando and another v. A. M. Ismail* SC Appeal No. 22 of 1981 S.C. Minutes of 2.4.1982.
2. *Re Poyser and Mills Arbitration* [1964] 2 Q.B.D. 467.

3. *Elliott and Others v. South Wark London Borough Council* [1976] 1 W.L.R. 499.

4. *Gurmukh Singh v. Commissioner of Income Tax* AIR 1944 SC 353 F.B.

APPLICATION for writs of prohibition and certiorari.
C. Sivaprakasam with *H. Devasagayan* for the Petitioner.

M. S. Aziz Deputy Solicitor-General for the Respondent.

Cur. adv. vult.

May 11, 1984

TAMBIAH, J.

There are two applications before us. In Application No. 2366 of 1980, the petitioner is New Portman Ltd; in Application No. 2367 of 1980, the petitioner was E.D. Gunaratne, who was the Managing Director of New Portman Ltd. He died while his application was pending before this Court, and his widow has been substituted in his place. New Portman Ltd. carries on the business of clearing, forwarding and transporting. On 29.2.80, New Portman Ltd. furnished a return (p1) of its income for the year of assessment 1979/80 to the 2nd respondent, who was an Assessor attached to Unit 1 of the Department of Inland Revenue. The return disclosed a total statutory income of Rs.12,210/- against which it claimed an allowable loss of Rs.197,374/- under s. 162 (b) (iv) of the Inland Revenue Act No. 28 of 1979. This amount was a loss brought forward from the previous year of assessment. According to the 1st respondent, an Assessor attached to Unit 9 of the Department, before the return of income was furnished, the Managing Director of the Company had discussions with the officials of the Department about the subject matter of the returns.

By letter dated 27.5.80, the 1st respondent called upon the Managing Director of the Company to produce the books of accounts and documents of the Company in respect of the year of assessment 1979/80. Accordingly, on 16.4.80, the books of accounts were handed over to the 1st respondent. The Cash Books handed over, covered only nine months of the year;

according to the petitioner company, the cash books for the balance year was missing and it attributed the loss of the cash books to the Accountant who had left his employment under the Company.

It is common ground that there was an interview with the 1st respondent on 17.6.80, at which interview, were present the Managing Director, his Counsel, the Accountant of the Company and the Deputy Commissioner, Unit 9. Parties are at variance in regard to what transpired at the interview. According to the petitioner company, the only question that was repeatedly put by the 1st respondent was whether the return of income was correct, and when the answer was in the affirmative, the 1st respondent became visibly annoyed: neither the 1st respondent nor the Deputy Commissioner questioned the petitioner company on the accuracy of the accounts furnished or sought any clarification as to how the accounts were made up or indicate in what respect the accounts were suspect. The petitioner asserts that certain submissions made by its Counsel were not noted down by the 1st respondent though requested to do so but that he requested them, if they wished, to send in their written submissions.

This position of the petitioner cannot be sustained as the 1st respondent has annexed the notes of the interview to his affidavit. Annexure (183) records that Counsel states: (1) the profits for the year ended 31.3.79 was reduced by about Rs. 100,000/- on the instructions of the accountant, (2) though factually the lorries were transferred to the Company in April 1978, the legal transfer took place later; that during this period, the lorry expenses were met out of drawings from the company, but the profit of the company was inflated because these expenses were not reflected in the profit and loss account. Counsel was requested by the Deputy Commissioner, to give his statement in writing.

On 25.6.80, the auditors of the company were afforded an opportunity of examining the books of account of the Company which were in the custody of the 1st respondent, and thereafter the Managing Director sent his written submissions on 19.8.80. It

would appear from the written submissions that the controversy between the Department and the Assessee centres round an entry in the ledger under "Mr. E. D. Gunaratne's A/c". According to the Managing Director, large sums of money drawn by him and expended on the company's behalf on account of repairs to vehicles, their maintenance and running expenses have not been charged against the profits for the year.

By letter dated 31.7.80 (P3), the 1st respondent purporting to act under S. 115 (3) of the Inland Revenue Act No. 28 of 1979 informed the petitioner company as follows :- "According to the information available with me the statement of accounts furnished by you in support of the return of income for the above year of assessment (1979/80), year ended (31.3.79) in respect of the above company (New Portman Ltd.) does not reveal the correct profit. I am therefore, rejecting the Return and an assessment on estimated assessable income of the company will be issued shortly."

Thereafter the 2nd respondent sent the notice of assessment dated 12.8.80 (P4) wherein the petitioner's income has been assessed at Rs.150,000/-, as against a statutory loss of Rs.155,164/- which, the petitioner states, was disclosed by it in its return.

The petitioner then wrote the letter (P5) dated 2.9.80 to the 1st respondent and stated that the assessment is ultra vires, null and void and one made without jurisdiction for the reasons that (1) the letter P3 does not comply with S. 113 (3) of the Act, as the 1st respondent had failed to communicate the reasons for not accepting the return, (2) there was a violation of the rule of *audi alteram partem* in that the 1st respondent had failed to confront the assessee with the information he had and to hear him on such information.

To this, the 1st respondent replied by his letter P7 of 9.9.80 and stated that a hearing was given to the petitioner on matters relevant to the assessment and that he had rejected the return and issued an assessment as he was not satisfied that the returns and accounts disclosed the correct income of the company.

The petitioner wants this Court to quash on Certiorari and Prohibition the assessment (P4) for the reasons that the mandatory provisions of S. 115 (3) have not been complied with by the 1st respondent, and that there has been a denial of natural justice as the petitioner has not been questioned on the information available to the 1st respondent.

In **Application No. 2367/80,** the petitioner who was the Managing Director of New Portman Ltd. on 19.11.79 sent a no income return (P1) for the year of assessment 1979/80 to the 2nd respondent. The 1st respondent, purporting to act under S. 115 (3) of the Act, informed the petitioner as follows:- "Your declaration that you have earned no income after the transfer of the lorry, has been rejected". (P2 of 31.7.82). He was also told that an assessment would follow. Thereafter, a notice of assessment dated 12.8.80 (P3 of 12.8.80) was issued by the 2nd respondent wherein the petitioner's income was assessed at Rs. 253,040/-. Here too, the petitioner's complaint is that the 1st and 2nd respondents have failed to perform their mandatory duty cast on them by S. 115 (3), in that, they have failed to communicate their reasons for not accepting his return. A further complaint is that he was not afforded an opportunity of being heard on matters affecting his liability to tax. Writs of Certiorari and Prohibition have been asked for to quash the assessment P3.

According to the affidavit of the 1st respondent, the petitioner, before he sent his return of income, has had discussions with the officials of the Department about the subject matter of the returns. Before his return was rejected by the letter P2, the petitioner with his Counsel and Accountant had interviewed the Deputy Commissioner and the 1st respondent on 17.6.80, and on 25.6.80, his Accountant had called over and examined the books of the Company. The 1st respondent asserts that the notice of assessment (P3) was issued by him after considering the representations made by the petitioner from time to time regarding the income from the hiring of lorries and the profits on sale of lorries. It is the 1st respondent's position that the petitioner has failed to disclose profits from transfer of lorries to the Company in his return for the year of assessment 1979/80 and that in the letter P2, he has duly communicated to the

petitioner the reasons for not accepting his return. In the light of the assertions made by the 1st respondent, which have not been countered by the petitioner, his allegation that he was not heard on matters affecting his liability to tax, has no basis.

The written submissions tendered by the petitioner to the 1st respondent (1R8) makes clear the matter in controversy between the Department and the assessee. The petitioner was engaged in clearing and transport business and had his own lorries. In June 1976, New Portman Ltd. was incorporated and the petitioner and his wife held all but a few shares. The company hired the petitioner's lorries. According to the petitioner, as from 1.4.78, the company took over possession and ownership of the lorries, but the legal transfers were effected later in the year. As from 1.4.78, he did not receive hire from the company, but he was allotted shares for the value of the vehicles handed over.

The petitioner in **Application No. 2366/80** seeks to quash the notice of assessment (P4) on two grounds :-

(1) the letter (P3) does not give the reasons for not accepting the return (P1), and

(2) the 1st respondent had failed to confront the assessee with the information available to him and to hear the assessee on it.

In **Application No. 2367/80,** the petitioner seeks to quash the assessment (P3) on the ground that the 1st respondent has failed to state in his letter P2 the reasons for rejecting his return (P1).

S. 113 (3) of the Inland Revenue Act No. 28 of 1979 reads as follows:-

"Where a person has furnished a return of income, wealth or gifts, the Assessor may in making an assessment on such person under subsection (1) or under subsection (2), either—

(a) accept the return made by that person; or

(b) if he does not accept the return made by that person, estimate the amount of the assessable income, taxable wealth or taxable gifts of such person and assess him accordingly:

Provided that where an Assessor does not accept a return made by any person for any year of assessment and makes an assessment or additional assessment on such person for that year of assessment, he shall communicate to such person in writing, his reasons for not accepting the return."

The provisions of this section came up for consideration in *Mrs. Fernando and another v. A. M. Ismail* (1). By a majority judgment, the Supreme Court held that the requirement to communicate reasons for non-acceptance of the return is a mandatory one, and the failure to state the reasons renders the notice of assessment null and void and liable to be quashed on Certiorari. As the assessee in this case denied the receipt of the letter communicating the reasons for the rejection of his return, and as the Department of Inland Revenue did not furnish satisfactory proof of the posting of the letter, the Supreme Court proceeded on the basis that the Assessor had failed to communicate to the assessee, the reasons for the rejection of the return. Samarakoon, C.J. observed — "The section requires the reasons to be stated and not the conclusion which he arrived at, though he may, if he so chooses, give his conclusions too. Furthermore, the section requires reasons for non-acceptance of a return which is an act of the Assessor. It is his thinking that has to be disclosed to the Assessee . . . In the present case the Assessor accepted the figures of assessable income and taxable wealth. He only rejected the claims for expenses and made his own assessment of expenses. The Assessor was then required to give reasons for such action."

As regards the letter P3 (C. A. **Application No. 2366/80**), while learned Attorney for the petitioner contended that no reasons for the rejection of the returns have been given, learned Deputy Solicitor-General argued that a reason has been given.

namely, the statement of accounts to support the return is false. He further argued that in any event, having regard to the discussions had prior to the sending of the return (which has not been denied by the petitioner), the interview had on 17.6.80 and the examination of the books on 25.6.80 by the assessee's accountant, the assessee knew what the assessor was talking about in his letter P3 and he knew why his return was rejected.

In *Re Poyser and Mills' Arbitration* (2) the landlord of an agricultural holding served a notice under S. 24 (2) (d) of the Agricultural Holdings Act, 1948, alleging that he was in breach of certain items of the tenancy agreement and requiring him to remedy those breaches within a period of four months. As the tenant had failed to comply with the notice to remedy, the landlord, in terms of the Act, served on him a notice to quit. In the schedule to the notice were set out seven items of supposed breach of clauses of lease. The tenant, in terms of the Act, required that there should be arbitration and an arbitrator was appointed by the Minister of Agriculture to determine whether or not there had been breaches of the lease and failure to remedy those breaches within the required or a reasonable time. The arbitrator determined that the notice to quit was a good notice. S. 12 of the Act provides that where the arbitrator gives any decision, it shall be the duty of the arbitrator to furnish a statement of the reasons for the decision, if requested. The tenant required of the arbitrator that he should state his reasons for the decision in the award. In stating his reasons the arbitrator in paragraph 3 stated- "I found faults in the notice to remedy in respect of certain items and ignored these items, but I found as a fact that there was sufficient work required in the notice which ought to have been done and was not done on the relevant date to justify the notice to quit."

On behalf of the tenant it was argued that there is an error of law in relation to paragraph 3, in that, there being seven items in the notice to remedy, the arbitrator has not said which of these items he found to be good, and which he found to be bad. He has not dealt with them individually; he has merely said that he found as a fact that there was sufficient work required in the notice which ought to have been done and was not done on the relevant date to justify the notice to quit.

Megaw, J. said (p.478)-

> "Parliament provided that reasons shall be given, and in my view that must be read as meaning that proper, adequate reasons must be given. The reasons that are set out must be reasons which will not only be intelligible, but which deal with the substantial points that have been raised . . . In my view, in the present case para 3 gives insufficient and incomplete information as to the grounds of the decision."

The Court treated inadequacy of reasons as an error on the face of the record and set aside the award.

In *Elliott & others v. South-Wark London Borough Council* (3) the plaintiffs were owner-occupiers of houses in a clearance area which has been classified as unfit for human habitation. The Council having made a clearance order under the Housing Act 1957, submitted to the Secretary of State a compulsory purchase order for confirmation. On objection being raised by the plaintiffs, the Secretary of State directed that a public inquiry be held. The Inspector, after inquiry, recommended that the compulsory purchase order be confirmed and the Secretary confirmed the order. On confirmation, the houses became liable to be demolished.

The Housing Act, 1974, made provision for rehabilitation of houses as an alternative to demolition. The plaintiffs applied to the Council for a "rehabilitation order" in terms of S. 114 (2) of the Housing Act, 1974. The applications were considered by a sub-committee of the Housing Committee and the Housing Committee of the Council, and the Council accepted their recommendation and refused the application. Schedule 10, para 3 (2) to the Act states that where the local authority refuses to make a 'rehabilitation order' it shall give the owner of the house in writing its reasons for so refusing. The Clerk to the Council wrote to each of the plaintiffs as follows :-

"I write to inform you that the Council, at their meeting on July 16, resolved to refuse the application for the reason that the properties should be demolished and the sites used for the

erection of new housing accommodation". The plaintiffs filed action and sought, inter alia, a declaration that the Council had failed to carry out their statutory duties under the Housing Act 1974, to consider, determine and give reasons for their decision upon the requests made for rehabilitation orders. The Judge dismissed the plaintiff's claim. He said - "It seems to me . . . that in the particular circumstances of the case which is being considered that it must appear to the satisfaction of any Court which is being asked to review the reasons that the recipient should fairly understand why it is that the housing authority is not able in this case to accede to the request. The question here is whether in the circumstances of this case those reasons do pass that test." The Judge held that "in the circumstances of the case, bearing in mind what had gone before," the letter by the clerk gave a reason for refusal which was adequate and intelligible to the recipient of the refusal. The words "what had gone before" was a reference to the public inquiry ordered by the Minister and the Inspector's report.

In appeal, for the plaintiffs it was argued that where a Statute expresses a duty to give reasons, the Court should imply a condition that persons given in discharge of that duty shall be adequate and intelligible and that the reasons, if any, given by the Council do not pass that test; that the purported reasons given were inadequate and did not convey to those who requested the making of rehabilitation orders why it was that the local authority was refusing their requests. For the Council, it was contended that the purported reason was adequate and intelligible.

The Court of Appeal upheld a two-line reason which merely stated that the Council had decided that the houses should be demolished rather than rehabilitated. The Court observed (pgs. 509, 510) that "against the background of the inquiry, the Inspector's report and the Secretary of State's decision letter . . to those who received the letters the reason for the refusal was intelligible and sufficient . . ."

Thus, in this case, the plaintiff's application was for a "rehabilitation order", instead of dealing with the houses by demolition. The reason that simply stated that "the property

should be demolished and the site used for the erection of new housing accommodation" was found to be adequate when considered against the background of arguments advanced at the inquiry and the Inspector's report.

I cannot accept the submission of learned Deputy Solicitor-General that the letter P3 gives a reason for the rejection of the return, namely, the statement of accounts given in support of the return is false. The statement of accounts is part and parcel of the return and is furnished in support of the return. The rejection of a statement of accounts is equivalent and tantamount to a rejection of return and vice versa. What S. 115 (3) proviso requires is the giving of reasons for concluding that the return cannot be accepted. The letter P3 has only stated a conclusion and not the reasons for the conclusion. The letter P3, therefore, does not satisfy the requirements of S. 115 (3) proviso.

The learned Deputy Solicitor-General, however, submits that "in the circumstances of the case, bearing in mind to what had gone before," - the discussions before the return was sent, the interview had on 17.6.80, the examination of books on 25.10.80 - to the assessee who was the recipient of the letter P3, the reasons for the rejection of his return was adequate and intelligible.

I cannot accept this contention either. The law as it stood before the amending Act No. 28 of 1978 is as follows:—

S. 93 (2) of Act No. 4 of 1963 —

"Where a person has furnished a return of income, wealth or gifts, the Assessor may either —

(a) accept the return and make an assessment accordingly; or

(b) if he does not accept the return, estimate the amount of the assessable income, taxable wealth or taxable gifts of such person and assess him accordingly."

The Amending Act No. 30 of 1978 retained S. 93 (2) but at the end of S. 93 (2) (b) added the words "and communicate to such person in writing the reasons for not accepting the return."

As was pointed out by the Chief Justice in *Ameer Mohideen Ismail's* case (supra) — "The picture is now different. A duty is now imposed on the Assessor not only to give reasons for non-acceptance of a return but also to communicate them to the Assessee". The mischief and defect in the old law which the amending Act sought to remedy are:

(1) to prevent arbitrary and grossly unfair assessments and to ensure that the Assessor will bring his mind to bear on the return and come to a definite determination whether or not to accept it. (ibid Samarakoon, C.J.).

(2) the Assessee could only speculate on the reasons for the rejection of his return for the purpose of his appeal. Now, the reasons for rejection are to be made known to the Assessee to enable him to demonstrate the untenability of the said reasons at the hearing of any appeal that may be preferred by him against the assessment (ibid Sharvananda, J.).

I find that in the above case, an argument was advanced on behalf of the Assessor that the requirement to give reasons does not apply to false returns. Admittedly, the return was a false return and did not disclose the true income. Dealing with this point, Samarakoon, C.J. said "No doubt there may be cases where the reasons for non-acceptance may be obvious but one must bear in mind the fact that the legislature has made no exception to the general rule and the duty cast on the Assessor must be carried out even though the Assessee himself accepts the obvious . . . I am of opinion that the Assessor is bound to give reasons for non-acceptance of a return without exception."

If I were to accept the learned Deputy Solicitor-General's contention having regard to what had gone before, the Assessee knew what the Assessor was talking about in his letter (P3) — I would be restoring the law to its old position and would fail to give effect to the vital change brought about by the amending law.

This apart, there is an additional reason why the notice of assessment (P4) cannot stand. The letter P3 speaks of "information available" to the Assessor. The Assessee's complaint is that this private information was not made known to him and he was not heard on it. The petitioner asserted this position in paragraphs 20, and 24 (b) of his petition, and in his letter P5 to the Assessor. The Assessor, neither in his affidavit nor in his letter P7, which is a reply to letter P5, contradicted the petitioner's position.

In *Gurmukh Singh v. Commissioner of Income Tax* (4) after the assessment was made, the income tax officer received information that the assessees had not disclosed in their returns large remittances they received from Siam, where they owned extensive business as well as considerable house property. Rejecting the explanations given by the Assessees on this matter, a sum of Rs. 40,000/- was added to the income returns by the assessees for the year 1934/35 and the two subsequent years. The questions on which the Opinion of the Court was sought were:

(1) Whether, after rejecting the accounts of an assessee, an income tax officer is bound to rely on the evidence adduced by the assessee ?

(2) If he makes his own estimate, is he bound to disclose the material on which he founds that estimate to the assessee ?

(3) Is he entirely debarred from relying on private sources of information which he may not disclose to the assessee at all ?

(4) In case he utilises the private inquiries made by law, is it enough for him to communicate the gist to the Assessee?

The Court answered these questions as follows (p. 363)—

> "An Income-tax Officer is not bound to rely on such evidence produced by the assessee as he considers to be false. If he proposes to make an estimate in disregard of the evidence,

oral or documentary, led by the assessee, he should in fairness disclose to the assessee the material on which he is going to found that estimate. He is, not, however, debarred from relying on private sources of information, which sources he may not disclose to the assessee at all. In case he proposes to use against the assessee the result of any private enquiries made by him, he must communicate to the assessee the substance of the information so proposed to be utilised to such an extent as to put the assessee in possession of full particulars of the case he is expected to meet and should further give him ample opportunity to meet it, if possible."

On the question whether the finding of fact arrived at by an Income-tax Officer is vitiated altogether if it is partly based on admissible material and partly on confidential enquiries, the substance of which was never disclosed to the assessee; Din Mohamed, J., who wrote the main Opinion, said (p. 365)—

"It may be urged that where it is not possible to determine how far the finding of fact was influenced by inadmissible material, the entire finding should disappear. But I do not consider that that consequence necessarily follows in every case. If the material that could not be used is so mixed up with the material that could be used as to make it impossible to separate one from the other, or, to put it in a different way, if the inadmissible material is the main foundation of the entire superstructure raised by the Income-tax officer, no doubt the finding will vanish as soon as the basis is destroyed . . . If there is any admissible material to support the finding of the Income-tax officer quite apart from the result of the confidential enquiries made by him and not communicated to the assessee, it will not be open to the High Court to declare the finding altogether vitiated."

Wade in his Administrative Law (4th Edn.) discusses this question under the heading "The right to a fair hearing".

"Comparatively recent Statutes have extended, if they have not originated, the practice of imposing upon departments

or officers of State the duty of deciding or determining questions of various kinds . . . They can obtain information in any way they think best, always giving a fair opportunity to those who are parties in the controversy for correcting or contradicting anything prejudicial to their view."

(pages 432, 433)

"Natural justice often requires the disclosure of reports and evidence in possession of the deciding authority . . . But this may sometimes be adequately achieved by telling him the substance of the case he has to meet, without disclosing the precise evidence or the sources of information."

(pages 459, 460)

For reasons I have given, I allow the application and quash the Notice of Assessment (p 4), in **C. A. Application No. 2366/80.** The petitioner will be entitled to costs fixed at Rs. 525/-.

In **Application No. 2367/80,** the only ground on which the Notice of Assessment (P3) is attacked by learned Attorney for the petitioner is that the letter P2 rejecting the return does not state a reason. In my view it does. The reason given is that the Assessee had not disclosed his income from the lorries. A clue is given to the petitioner as to where he had gone wrong in his return. To the petitioner who received P2, the reason given is adequate and intelligible to enable him to formulate his grounds in order to appeal to the Commissioner. I refuse the application for Writs. The substituted petitioner will pay Rs. 525/- as costs to the respondents.

MOONEMALLE, J. — I agree.

Writ allowed in Application No. 2366/80

Application refused in No. 2367/80