1961 *Present* : Basnayake, C.J., and Sinnetamby, J.

HAYLEY & CO., LTD., Appellant, *and* COMMISSIONER OF INLAND REVENUE, Respondent

S. C. 8/60—Income Tax Case Stated BRA. 287

come tax—Loss suffered by burglary—Right of assessee to deduct it from profits or income—" Outgoings and expenses "—Income Tax Ordinance (Cap. 188), ss. 5, 6 (1) (a), 9 (1), 10 (c).

The assessee was a limited liability company which carried on a business in the export of rubber and other produce which it purchased in open market. Large sums of money were kept each day in the office safe for the purpose of making purchases on the following day. One night the Company's office was burgled and its safe was removed with all its contents.

Held, that the nett loss suffered by the burglary was an " outgoing " deductible under section 9 (1) of the Income Tax Ordinance for the purpose of ascertaining the profits or income of the Company from its trade or business.

CASE stated under section 74 of the Income Tax Ordinance (Cap. 188).

H. W. Jayewardene, Q.C., with *S. Ambalavanar* and *N. R. M. Daluwatte*, for the assessee-appellant.

B. C. F. Jayaratne, Crown Counsel, with *M. Kanagasunderam* and *H. L. de Silva*, Crown Counsel, for the assessor-respondent.

Cur. adv. vult.

July 10, 1961. BASNAYAKE, C.J.—

I have had the advantage of reading the Judgment prepared by my brother Sinnetamby. I am in agreement with the opinion he has expressed and the order he has made as to costs but I wish to add a short note of my own.

The only question for decision is whether the net amount of the loss sustained by the assessee by the burglary of his office safe may be deducted under section 9 (1) of the Income Tax Ordinance for the purpose of ascertaining the profits or income of the assessee from the source described in section 6 (1) (*a*) as " profits from any trade, business ".

Briefly the material facts are as follows : The assessee is a limited liability Company carrying on business in Galle. One of the Company's business activities is the purchase of rubber for export. For the purpose of paying for the Company's purchases of rubber it withdrew from its Bank on every day on which it was open sufficient money to pay for its purchases on each business day. On 17th April 1952 the Company drew Rs. 96,075 for the purpose of paying for its purchases. On the night of 19th April the Company's Office was burgled and its safe was removed with its contents. A sum of Rs. 23,775 was recovered by the Police thereby reducing the amount of the loss to Rs. 72,300. Although the assessee had insured against loss by theft, the Insurance Company for some reason which is not disclosed, refused to meet the loss of Rs. 72,300 but made an ex-gratia payment of half of it. The assessee's loss was thereby reduced to Rs. 36,150 which sum it claimed it was entitled to deduct for the purpose of ascertaining its profits from its trade or

business. The Assessor disallowed the claim and the Company appealed. The Authorised Adjudicator also disallowed its claim. The Company thereupon appealed to the Board of Review, which also disallowed the claim. The Company expressed its dissatisfaction with that decision and asked that a case be stated to this Court.

Section 9 (1) deals with three classes of deductions. One is " outgoings ", the second is " expenses incurred by the assessee in the production of the profits or income ", and the third is the specific deductions allowed by paragraphs (a)-(i) thereof. The word " outgoings " means what goes out and is a word of wide import. It is the opposite of the equally wide expression " income ", which means what comes in. In the context the word " expenses " is limited by the words " incurred by such person in the production thereof " while the word " outgoings " is not so limited. The two words are designed to express two different concepts one of wider import than the other. All outgoings are not expenses incurred in the production of the profits or income; but all expenses incurred in the production of the profits or income are outgoings. Apart from expenses incurred in the production of the profits or income the section specifically mentions other outgoings. The word " outgoings " in this context must be construed as outgoings other than those specifically mentioned. Whether a particular " outgoing " is deductible for the purpose of ascertaining the profits or income of a business would depend on the circumstances of each case subject to the provision of section 10 (*c*) which forbids the duduction of any expenditure of a capital nature or any loss of capital. Where an outgoing is not of a capital nature or a loss of capital or where its deduction is not expressly forbidden by the statute, it is deductible under section 9(1) and it is not for the taxing authorities to say that the payment should not have been made.

The appellant's loss in the instant case is not a loss of capital and does not therefore come within the prohibition in section 10 (*c*). Little assistance can be gained by examining the decisions on the taxing laws of other countries as they are rarely the same; but in this instance the Australian case of *Alliance Assurance Co. Ltd. v. Federal Commissioner of Taxation*[1] affords some assistance. In that case the Court was called upon to construe sub-clause (*a*) of Section 18 (1) of the Income Tax Assessment Acts 1915 (34 and 47 of 1915) which reads—" in calculating the taxable income of a taxpayer the total income derived by the taxpayer from all sources in Australia shall be taken as a basis, and from it there shall be deducted (*a*) all losses and outgoings, not being in the nature of losses and outgoings of capital, including commission, discount, travelling expenses, interest, and expenses actually incurred in Australia in gaining or producing the gross income." Knox C.J., Gavan Duffy, Rich and Starke J.J., with whose judgment Higgins J. expressed his agreement in a separate judgment, stated—

" In our opinion the words ' all losses and outgoings ' which occur at the beginning of sub-clause (*a*), extend to all losses and outgoings

[1] *29 Commonwealth L. R. 424 at 430.*

of the business not being in the nature of losses and outgoings of capital and are not qualified by the words 'incurred in Australia in gaining or producing the gross income'. We think these latter words refer either to the word 'expenses' only, or at most to the words 'commission, discount, travelling expenses, interest, and expenses'. In our opinion this is the natural grammatical construction of the words used. Moreover, the construction contended for by the Commissioner would lead to the result that the cost of goods purchased and paid for in England and afterwards sold in the carrying on of a business in Australia could not be allowed as a deduction from the proceeds of sale in arriving at the taxable income of the taxpayer."

In the instant case the sum of Rs. 36,150 cannot be described as expenses incurred in producing the profits of the business but it is an outgoing deductible under section 9 (1) in ascertaining the profits or income.

SINNETAMBY, J.—

The assessee, Messrs Chas. P. Hayley & Co., Ltd. is a firm carrying on a business in the export of rubber and other produce which it purchases in the open market. The facts stated by the Board of Review show that the firm's business involves work outside the normal working hours of the banks, that it was necessary for it to keep large sums of money in the office safe for the purpose of making purchases of rubber and other commodities in which it deals, and that money sufficient for its needs is withdrawn from the bank each day and kept in the office safe till it is utilised on the following day for the purpose of making purchases. In this way, on 17th April, 1952, the company withdrew from the bank a sum of Rs. 96,075 in order to make the purchases it intended to make on the 21st, the 18th and 19th of April being bank holidays and the 20th being a Sunday.

It would appear that on the night of the 19th of April, the place of business of the assessee was burgled, and the safe removed with all its contents. The police recovered a sum of Rs. 23,775 from some of the burglars, one of whom happened to be an employee of the assessee: presumably, he was not a high official in the company. The company, apparently, had insured itself agaist losses of this kind; but, for some reason not disclosed, the Insurance company denied liability to indemnify them for the loss: nevertheless, the insurance company made an ex gratia payment of Rs. 36,150. The balance of Rs. 36,150 was a complete loss which the assessee had to bear.

The assessee, in making its income tax return for the year of assessment in question, claimed originally a deduction of Rs. 72,300, which is the amount of the loss unrecovered by the police; but, subsequently, limited the claim to the nett loss sustained, namely Rs. 36,150. Both the Authorised Adjudicator and the Board of Review held against the assessee, on the basis that this loss was a loss of capital and not a loss which, in terms of section 9 (1) of the Income Tax Ordinance, was an outgoing or expense "incurred by such person in the production of profits or income".

The question referred to this court for its opinion is whether, in the circumstances of this case, the loss of Rs. 36,150 is a loss of capital or an outgoing incurred in the production of profits.

On the facts, the Board of Review held that the money was brought from the bank to the business premises of the assessee for the purpose of the business in which the assessee was dealing. Nevertheless, they took the view that, inasmuch as our Ordinance limits the amount deductible to " outgoings or expenses " incurred in the production of profits, a " loss " would not come within the term and was, therefore, not a sum which could properly be deducted to ascertain the nett profits of the business. In this way, they chose not to follow the decision in the case of *Charles Moore & Co. v. Federal Commissioner of Taxation* [1] to which they referred. The wording of the Tax Act which was interpreted in that case provided for " losses and outgoings and expenses " to be legitimate deductions. Inasmuch as our section does not include the word " losses ", the Board of Review seemed to think that the loss in question could not be deducted. It is, therefore, necessary to consider the meaning to be attached to the term " outgoings and expenses ".

The imposition of income tax by section 5 of our Ordinance is based upon the profits or income as calculated in accordance with the provisions of the Ordinance. In, therefore, interpreting the expression " outgoings and expenses ", one must permit such deductions as may reasonably and in a commercial sense be made, in order to ascertain nett profits. The word " outgoings " must not be limited to voluntary payments. It would also include involuntary outgoings such as petty thefts by subordinate officers in the employ of the assessee as well as by outsiders. It was conceded that losses incurred in this way are permissible deductions ; for instance, thefts in a grocery store or in a shop by customers as well as minor employees are well recognised as being deductible in ascertaining the nett profits. They are losses in much the same way as the Rs. 36,150 involved in this case, was a loss. If the Board of Review is correct in the construction they have placed on the words " outgoings and expenses ", even such losses would not be deductible in view of the distinction they seem to have drawn. It seems to me that the word " outgoings " is wide enough to cover losses, for a loss, after all, is an involuntary outgoing. I may add that learned Crown Counsel did not seek to support the decision of the Board of Review on this ground. The " outgoings ", however, must be outgoings of such a nature as would come within the meaning of the expression " incurred in the production of profits ".

The question that must be decided is whether a loss of the kind in question is a loss which is incidental to or inevitable in the conduct of the business which produces the income. If so, it is deductible. Crown Counsel contended that it is only where stock in trade is lost that a deduction is permissible, and once goods are sold in a business which involves the sale and purchase of goods, the money which is brought " into the till " if lost, would be a loss of capital and, therefore, not deductible.

[1] *Australian and New Zealand Reports p. 739.*

It seems to me that the fallacy in that argument lies in the fact that the money " in the till " represents and replaces the stock in trade and, so long as it is in the till in that capacity, the loss of a portion of it would be equivalent to a loss of stock in trade. In *Green v. Commissioner of Inland Revenue* [1] the question that arose was whether the money paid by an insurance company as replacement or market value of timber which had been destroyed by fire, or the book value of the timber in the company's books, should be the permissible deduction ; and Lord Hanworth, in dealing with the question, made the following observations :—

> " They had a certain amount of fixed capital in their business, and they had a certain amount of circulating capital employed in the purchase of stock, which is enhanced again when the stock is sold. A part of that circulating capital was invested in timber. That timber might have been sold in the ordinary course of market—as a matter of fact, instead of being actually sold it was burnt. Under a contract of indemnity, properly entered into for the purpose of safeguarding the possibilities of business in relation to it, a sum has been received in respect of the timber. That is once more a restoration to the actual circulating capital of a sum which had previously been invested *in specie* in timber. We have got to take the actual sum received, which has been received in the ordinary course of business, plus the ordinary safeguards of business in the events which have happened. As Mr. Justice Rowlatt says : ' It seems to me that the Respondents must account for this timber that has been destroyed by fire ; they have received the money from the Insurance company in place of it . . . the fact is that the Respondent's business is to buy, hold and sell timber, and it is part of their business to insure timber while they have it, in order that if the timber is destroyed they may have the insurance money instead of the timber and, in my judgment, they must treat that money in the same way as they would have treated the timber, namely, as an item in their trading account '. Those are the words of Mr. Justice Rowlatt. It appears to me that they are right. "

In the present case, on the facts stated, the money that was brought from the bank by the assessee was, to use the words of Lord Hanworth, " circulating capital " and probably represented the proceeds of previous sales of the company's stock in trade. Although " in the till ", the money represented stock in trade and was definitely intended to be utilised to replenish stocks. The Boad of Review, quite rightly, rejected the Authorised Adjudicator's opinion that " what the cash lost represents and why it was brought and kept in the safe are not matters germane to the issue ", and found that the " money was brought for the purpose of the purchase of rubber and other commodities that they were dealing in ". It clearly was " circulating capital " and not " fixed capital ", and if its loss was occasioned in the exercise of some step that had to be taken for the conduct of the company's business, it must surely be regarded as a casuality or a misfortune incidental to that business. It was

[1] *Income Tax Reports. 14 Tax Cases. 1928/29. p. 377.*

an involuntary outgoing over which the assessee had no control, and involved a risk which had to be taken in the ordinary course of business in order to produce profits.

The two cases of *Bansidhar Onkarmai v. Commissioner of Income Tax* [1] and *Ramaswami Chettiar v. Commissioner of Income Tax (Madras)* [2] on which the Board of Review relied are distinguishable on the following grounds :—

In the former case, the court took the view on the facts that the theft did not occur in the course of business while the business was being conducted and, therefore, the loss was not a loss incidental to the conduct of the business. Narasingham, J. observed that the loss cannot be regarded as one that was likely to occur having regard to the peculiar risks attendant upon the conduct of the business of the assessee : furthermore, the learned Judge stated that on the facts found by the tribunal from which the appeal was taken, there was no evidence that the money stolen was the stock in trade of the money lending business which the assessee in that case was carrying on. As a matter of fact, the theft in that case was committed by the accountant of the firm : and it is now a well established principle that where theft or embezzlement is committed by a high officer of a business, such as a Director or a Manager, the loss cannot be regarded as a trading loss, the principle being that the person in such a position having control of the company's money, when he takes it, is in the same position as the owner of the business. This principle appears to have been first laid down in the case of *Curtis v. Oldfield Ltd.* [3] As was observed by Chief Justice Letham, in *Commissioner of Income Tax v. Ash* [4] referring to thefts by employees :—

> " the case is different when income is actually received and then misapplied by the proprietor of a business or a person in the position of a proprietor as for example the Manager of the Company."

In that case, monies misappropriated by a partner was not regarded as a permissible deduction. Ordinarily, an expenditure which is closely associated with the requirements of a business is a permissible deduction but as Chief Justice Letham states, such a statement cannot be regarded as exhaustive. Each case must be decided on the facts and circumstances in which the loss occurred.

In the case of *Ramaswami Chettiar v. Commissioner of Income Tax (Madras)* (supra) the appellant was doing business in money lending, and one night certain persons broke into the premises and removed cash and jewllery to the value of Rs. 9,335. The court held that there was no evidence that the money which was stolen was stock in trade and that the loss was not incidental to the business of money lending. This was the view of the majority constituting the bench, but Justice Anantakrishna Ayyar wrote a strong dissenting judgment. The learned Chief Justice took the view that the loss was not incidental to the business and gave as an illustration the case of a man who having collected his

[1] *(1949) I.T.R. p. 247.*
[2] *A.I.R. (1930) (Madras) p. 808*
[3] *(1925) 9 Tax Case p. 319.*
[4] *Commonwealth Law Reports, 1938/39. Vol. 61. p. 263.*

profits was subsequently robbed of them by a stranger to the business. Such a loss was not incidental to his business. With all respect, I believe the learned Chief Justice took too narrow a view of the meaning that should be attached to the word "incidental to the business". As Chief Justice Ash, in the case I have already referred to, observed,

> "an expenditure which is directly associated with the daily requirements or exigencies of the business will be an allowable deduction but such a statement as this cannot be regarded as exhaustive. The line is sometimes difficult to draw."

The Board of Review also referred to the case of *Mulchand Harilal* [1]. In that case, money had been stolen while it was being taken to the bank. The court took the view that this was not a permissible deduction under section 10 (9) of the Indian Income Tax Act of 1922 which permitted the deduction of "any expenditure....incurred solely for the purpose of gaining such profits or gain". That opinion, however, has subsequently been declared to be obiter, as in that case the appeal was dismissed on the ground that the loss in question was sustained not in the year of assessment which was under review, but in respect of another year of assessment, vide *Bansidhar Onkarmai v. Commissioner of Income Tax* (supra). *In Motipur Sugar Factory Ltd. v. Income Tax Commissioner* [2] the High Court expressed the opinion that the provisions of section 10 (2) of the Indian Income Tax Act which permits the deduction of expenditure incurred solely for the purpose of producing profits or gain did not cover a case of theft while money was being taken for the purchase of goods; but, nevertheless, having regard to the provisions of section 10 (1) which imposes a tax on profits and gain, the words "profits and gains", it held, must be understood in a commercial sense, and a deduction was therefore permitted. The learned Judges quoted with approval the observations of Lord Parker, in *Usher's Wiltshire Brewery Ltd. v. Bruce* [3], to the following effect:—

> "where a deduction is proper and necessary to be made in order to ascertain the balance of profits and gains, it ought to be allowed, notwithstanding anything in the first rule or in s.159, provided there is no prohibition against such an allowance."

The Judges expressed the view that section 10 (1) of the Indian Income Tax Act must be considered in the light of this general principle.

In my opinion, the loss incurred by the assessee in this case is something which must be regarded as incidental to the assessee's business, and which any commercial undertaking would deduct from its income in order to ascertain its nett profits. In other words, I would hold that it must be deducted from the gross income to ascertain the nett profits. The question referred to us is, accordingly, answered in favour of the assessee and against the taxing department. The Commissioner of Inland Revenue will pay costs of this reference to the assessee.

Appeal allowed.

[1] *A. I. R. (1938) (Patna) p. 159.* [2] *28 Income Tax Reports. (1955) p. 128.*
[3] *(1915) Appeal Cases 433.*