

**SHANMUGANAYAGAM AND ANOTHER**  
**V.**  
**THE COMMISSIONER - GENERAL OF INLAND REVENUE**

SUPREME COURT  
FERNANDO J.  
AMERASINGHE J. AND  
DHEERARATNE J.  
S.C. APPEAL NO. 1/88  
CA/LA/SC NO. 28/87  
CA NO. 1/79  
02 JULY 1991.

*Income Tax - Test applicable to new undertaking for exemption of income tax - Inland Revenue Act, No. 4 of 1963, section 6 - Commencement of new venture.*

Mrs. Edmund Rodrigo ran a saree printing work-place for rural girls - her object being to assist the girls to advance themselves. She supplied them with imported cloth and the girls printed and sold the sarees. Mrs. Rodrigo levied a small charge from the profits of each saree. On 20.9.1966 the business was registered as Flower Textiles.

On 28.2.1968 the business was converted into a partnership under a new proprietary arrangement. A Mrs. Shanmuganayagam and others joined the venture. Earlier the business had been conducted at the residence of Mrs. Rodrigo and later at the residence of Mrs. Shanmuganayagam. Mrs. Rodrigo ceased to be a partner on 31.8.1968. In the meantime the business had developed. The partnership purchased raw material and sold the manufactured goods. In September 1968 the business was moved to a newly constructed building at Edmonton Road.

Mrs. Shanmuganayagam (one of the partners) claimed exemption from liability to pay taxes on her share of the profits and income from Flower Textiles for the years 1970/71 and 1971/72. The Commissioner of Inland Revenue disallowed Mrs. Shanmuganayagam's claim. In appeal the Board of Review held with the Commissioner. As Mrs. Shanmuganayagam was not in agreement, six questions turning on the date of commencement of commercial production were referred to the Court of Appeal. The Court of Appeal held that commercial production commenced in 1964/65. An appeal was referred to the Supreme Court.

**Held:**

- (1) Section 6 of the Inland Revenue Act No. 4 of 1963 grants income tax exemption to an industrial undertaking commenced after 01 April 1951 provided the Commissioner of Inland Revenue is satisfied inter alia, that "the undertaking is not formed by the splitting up or reconstruction of any business previously in existence."
- (2) Whether an undertaking is a new venture or an old one would depend on a variety of factors. The transfer of assets from the old business to the so called new venture would be one indication of *continuation* after reconstruction as opposed to the creation of an altogether new venture. Here the quotas of raw materials and foreign exchange allocated to Mrs. Rodrigo constituted the most important asset of the venture and continued even after she retired.
- (3) As it was in the beginning, the business always continued to be the printing of sarees. A business may be conducted in a somewhat altered or varied form and, indeed, there may even be a complete reconstruction of the old venture but it may nevertheless continue to be the old business. Instead of farming out work here the partnership employed a permanent staff. Significantly the accounts of the continuing partnership were made up for 12 month periods from the date of retirement of Mrs. Rodrigo's, viz. 31<sup>st</sup> August.
- (4) Section 6 does not reckon the date of commencement of the 5 years period (for exemption) from the date of commercial production. In any event the business was of a commercial nature. Profit may have been at first incidental. Gradually partial altruism was replaced by the total motive of pecuniary gain. The business was commercial from its beginning.

**Cases referred to**

1. *Commissioner of Income Tax V. Gaekwar Foam Rubber Co. Ltd.*, 35 1 TR 662, 669, 670.
2. *Textile Machinery Corporation V. Commission of Income Tax* 107 TR 195, 203, 204.

APPEAL from answers supplied by Court of Appeal to question referred by the Income Tax Board of Review.

*K. Nadarajah with Miss. M.P.C. Joseph and R.G.L. de Silva* for appellants

*K. Sri Pavan S.S.C.* for respondent - respondent.

*Cur. adv. vult.*

12 July 1991

**AMERASINGHE, J.**

One Mrs. Edmund Rodrigo had, at her residence at No. 4, Flower Terrace, taught girls from rural areas the art of printing sarees. She supplied them with cloth imported on the basis of quotas and import licences granted to her for this purpose by the Ministry of Industries. The printed sarees were sold by the girls. The principal object of this venture was to assist the girls to advance themselves in life. However, Mrs. Rodrigo levied a charge varying from Rs. 1 - 1.50 on the profits from each saree sold. In the year of assessment 1965/1966 she had, according to the tax return (R6) made by her husband, received a sum of Rs. 7000 from this levy of Rs. 1 - 1.50. In the following year of assessment he acknowledged in the tax return (R7) the receipt of Rs. 7000 from the levy. In the next year Mr. Rodrigo in the tax return (R8) acknowledged the receipt of Rs. 3695 from the levy. On 20 September 1966 the venture was registered under the Business Names Ordinance (Cap. 149) as a business under the name of "Flower Textiles". In his tax return for 1968/1969 (R9) Mr. Rodrigo stated that the business of Flower Textiles was closed down in April 1967.

However, on 28 February 1968 the business which was, as it were in a state of suspended animation was re-vivified under a new proprietary arrangement. The business was converted into a partnership, with four others, including one Mrs. C. Shanmuganayagam, one of the two Appellants in this case, (the other being her husband) joining Mrs. Rodrigo in her saree-printing venture. The particulars in the Certificate of Registration under the Business Names Ordinance were duly amended to reflect the change.

The business of Flower Textiles under the partnership was not conducted at the residence of Mrs. Rodrigo but at the residence of Mrs. Shanmuganayagam at No. 103, Hulftsdrop Street. The business at Hulftsdrop Street was carried on by contracting with other textile

printers to do the work of printing. The partnership purchased raw material and sold the manufactured goods. Mrs. Rodrigo ceased to be a partner on 31st August 1968. Between the date of the revival of the business in the form of a partnership (28 February 1968) and the date of retirement of Mrs. Rodrigo (31 August 1968) from the partnership business, the partnership had a turnover of Rs. 43,403.

A new building was constructed at Edmonton Road at a cost of Rs. 14,000 in which new equipment purchased for Rs. 2449 was installed. The business expanded rapidly after it moved in September 1968 to its new home at Edmonton Road. When Mrs. Shanmuganayagam, one of the partners, was called upon to pay taxes, she claimed that she was not liable to pay taxes on her share of the profits and income from Flower Textiles for the years 1970/1971 and 1971/1972. Her contention was that, in terms of Section 6(2) (ii) of the Inland Revenue Act No. 4 of 1963, the income and profits from Flower Textiles was entitled to exception from tax for a five year period as a new industrial undertaking which had commenced business in September 1968.

The Commissioner of Inland Revenue disallowed Mrs. Shanmuganayagam's appeal. He was of the view that Flower Textiles was not within the five year period during the years of assessment 1970/71 and 1971/72. She then appealed to the Board of Review which held that, although the profits of the business known as Flower Textiles were exempted from tax from the year of assessment 1965/66 to the year of assessment 1969/1970, the profits for the years of assessment 1970/71 and 1971/1972 did not fall within the 5 year period of exemption referred to in Section 6 of the Inland Revenue Act.

Since Mrs. Shanmuganayagam was not in agreement with the decision of the Board of Review, the Board of Review in terms of section 102 of the Inland Revenue Act No. 4 of 1963 submitted the case to the Court of Appeal for its opinion on the following questions:

- (a) Whether on the evidence led in the case the Board of Review erred in law in coming to the conclusion that the commercial production of the business of Flower Textiles commenced in the year 1964/65 as there was no industrial undertaking of Flower Textiles prior to the year of assessment 1967/68,

- (b) Whether the Board of Review erred in law in determining that the profits of the business of Flower Textiles were exempted from tax from the year of assessment 1965/66 to 1969/70, which question was not in fact referred to the Board of Review for decision, as there was no such business of Flower Textiles in existence prior to the year of assessment 1967/68;
- (c) Whether on the evidence in the case the Board of Review erred in law in holding that the commercial production of the business of Flower Textiles commenced earlier than September 1968;
- (d) Whether on the evidence led in the case the Board of Review has erred in law in holding that the industrial undertaking of Flower Textiles consisting of textile printing and processing was formed in 1968 in terms of Section 6(1) (ii) of the Inland Revenue Act No. 4 of 1963 by the splitting up or reconstruction of a sales commission business carried on by Mrs. E. Rodrigo since 1964 without any equipment as expressly declared in her Income Tax Returns;
- (e) Whether the Board of Review erred in law in stating that the profits of the business of Flower Textiles for the years of assessment 1970/71, 1971/72 are liable to tax.
- (f) Whether the Board of Review could have reached the conclusion that the business under consideration commenced in 1964/65.

After several days of hearing, the Court of Appeal reserved Order and on 27.11.1987 answered the questions (a) - (e) in the negative and question (f) in the affirmative.

This is an appeal from that Judgment of the Court of Appeal. The essence of Mr. Nadarajah's submission on behalf of the Assessee-Appellants is that the business conducted at Edmonton Road from September 1968 was a new industrial undertaking producing approved goods or commodities and it was therefore entitled to exemption from tax under Section 6 of the Inland Revenue Act for the years of Assessment 1970 - 1971 and 1971 - 1972, which years fell within the five year tax exemption period.

Mr. Nadarajah submitted that a provision such as Section 6 of the Inland Revenue Act No. 4 of 1963 ought to be liberally construed so that effect might be given to the intention of Government to encourage

industrialization by the setting up of new enterprises. He conceded, however, that there was no ambiguity in the section. In the circumstances, in my view, there is no need for construction. I must give effect to the plain meaning of the words of the section.

Section 6 of the Inland Revenue Act No. 4 of 1963 grants income tax exemption to an industrial undertaking commenced after 1 April 1951 provided the Commissioner of Inland Revenue is satisfied, *inter alia*, that "the undertaking is not formed by the splitting up or reconstruction of any business previously in existence . . ."

Mr. Nadarajah says that the Edmonton Road operation was a new venture and not formed by a splitting or reconstruction of the Hulftsdorp or Flower Road venture. Whether an undertaking is a new venture or an old one in that sense would depend on a variety of factors. The transfer of assets from the old business to the so called new venture would be one indication of *continuation* after reconstruction as opposed to the *creation* of an altogether new venture. In this case, the quota of raw materials and foreign exchange allocated to Mrs. Rodrigo constituted the most important asset of the venture and continued during the period when Mrs. Rodrigo was a partner and after she retired from the partnership of Flower Textiles.

Mr. Nadarajah cited the decisions in *Commissioner of Income Tax v. Gaekwar Foam Rubber Co. Ltd.* (1) and *Textile Machinery Corporation v. Commission of Income Tax* (2). These decisions make it clear that, where, as in this case, an undertaking carries on its former activities without loss or abandonment of its original activities or identity, it would not be new, distinct and separate from the old business. As it was in the beginning, the business always continued to be the printing of sarees.

A business may be conducted in a somewhat altered or varied form and, indeed, there may even be a complete reconstruction of the old venture, but it may nevertheless continue to be the old business.

The Edmonton Road operation was located at a new address. It was set up in a new building which was constructed at a cost of Rs. 14,000. Equipment worth Rs. 2449 was installed in these premises and instead of "farming out" work, the partnership employed a permanent staff of 25 workers and 15 casual employees. Its turnover

increased to Rs. 412210/77 during a twelve month period. Significantly, the accounts of the continuing partnership were made up for twelve month periods from the date of retirement of Mrs. Rodrigo, viz. 31 August. Admittedly the venture had flourished and the place and mode of doing business were altered to meet the growing needs of the venture and to further improve its efficiency and productivity. But it was the business Mrs. Rodrigo started at Flower Road.

It was alleged that the "commercial production" of business of Flower Textiles commenced after September 1968, that is after it moved to Edmonton Road. Section 6 does not reckon the date of commencement of the five year period from the date of *commercial* production. In any event the business was of a commercial nature. Profit may have been at first incidental. Gradually, partial altruism was replaced by the total motive of pecuniary gain. But the business was commercial from the days of its beginnings on the verandah of Mrs. Rodrigo's residence, for in exchange for the supply of raw materials and guidance on printing and advice on marketing, she received a commission from the sale of each saree. The *dominant* motive in the early days may have been regard for the welfare of the rural girls. But it was not the only purpose.

I affirm the Order of the Court of Appeal with regard to the answers given by it in response to the case stated by the Board of Review and dismiss the appeal without costs. However, it is not necessary for me to consider the observations of the Court of Appeal with regard to the question of the appropriate circumstances for judicial intervention in relation to the decisions of the Commissioner and I refrain from deciding that matter.

**FERNANDO, J.** - I agree.

**DHEERARATNE, J.** I agree.

*Appeal dismissed.*