Former Attorney General delves on 'Justice to Taxpayers in Sri Lanka'

The Faculty of Taxation of the Institute of Chartered Accountants of Sri Lanka recently organized its 17th Annual Tax Oratio, held on 25th October 2012 at the Institute's auditorium. This year's oration delved on a very topical theme 'Justice to taxpayers in Sri Lanka'; delivered by the former Attorney General, Mr. Mohan Pieris. The event attracted a significant number of tax professionals, including high-profile tax officials from the public sector to tax orators, members of the general public who show a keen interest in the subject and a significant number of Chartered Accountants. The Medallion for this event, as in all preceding events, was sponsored by renowned philanthropist, Mr. Esmond Satarasinghe, who is the only surviving member of CA Sri Lanka's first Council and a former member of the Income Tax Board of Review.

The below is the oration (unedited) delivered by Mr. Mohan Pieris.

Mr President,

Honourable Members of the Institute of Chartered Accountants of Sri Lanka

Ladies and Gentlemen

It is indeed a privilege and pleasure that I today have the opportunity of sharing my thoughts at your 17th Annual Oration on Taxation. Your institute deserves our plaudits for the yeoman service it has been rendering for almost two decades to edify and elucidate the labyrinth of tax laws in the country and I feel honored that I join today the star studded band of speakers who have regularly contributed to the series of orations.

You will acknowledge that in dealing with the subject of taxation one would be dealing with an anxiety as the taxation itself, and one which is world-wide. Lord Howe, a member of the House of Lords had the occasion to speak about this world wide problem of taxation to Addington Society –a society like yours devoted to taxation. He described the UK tax regime, even in those bygone days of the 70's as, incomprehensible, unrespected, unenforceable—and spinning like a top. That was a call to simplifying the tax system.

Perhaps I may quote a comment from the United States, extracted from the San Diego Law Review – a comment that also calls our attention to the necessity for simpler and easy to understand tax system-I quote

"If taxes had existed in the Garden of Eden, the Serpent wouldn't have needed an apple; the promise of a simpler tax system alone would have seduced Eve"

So Gentlemen, Looking around the world, that gives us comfort. One discovers that we are by no means alone.

There is a perennial battle between those who would have tax legislation set out in endless, remorseless detail to **give** it an air of certainty and those who would like fewer words with more room to breathe.

In this process judges play an important role in giving certainty to an otherwise intractable provision of law and these are the thoughts that goad me today to speak to you on some important aspects of interpretation that have contributed to certainty. But of course what has been laid down as propositions of certainty may become an important tool in the hands of lawyers and decision makers to cause uncertainty at times and I propose today to deal with issues that have contributed to tax jurisprudence but yet continue to engender uncertainty. My focus would also be on cases that have seminally shaped the tax jurisprudence in the country and how they have engendered uncertainty.

Sri Lanka can boast of a host of fiscal legislation dealing with revenue collection but the major enactment that deals with direct taxation is the Inland Revenue Act that has been the focus of amendments from time to time. We today have settled down for the Inland Revenue Act, No 10 of 2006, which has itself been amended five times since it was enacted a little more than six years ago. The amendments were enacted in 2007, 2008,2009, 2011 and 2012.

Litigation has been galore under our revenue statutes and you can observe that the tax jurisprudence has developed mainly in three ways.

Firstly there is the process of appeal by way of "Case Stated" under the Inland Revenue Act, which arises from a **disputed amount** in an assessment of income.

Secondly by way of a Writ application or what lawyers call judicial review. This second route of judicial review developed phenomenally in a test case which the Attorney General's Department filed in the Supreme Court by way of an appeal. Of course the assessor who made the assessment has been immortalized in the case because of the significant impact the case has had on tax law namely D.M.S Fernando. Thanks to this case today- we have the availability of a writ remedy against an assessment. I will presently return to this case.

Third route which has given rise to judicial precedents, would be the revision applications that are filed against orders of the magistrates in recovery proceedings. This avenue has also produced some useful case law that need to be studied for its reach and breath of analysis.

Quite germane to the second route of development in fiscal jurisprudence is the duty to give reasons that figures today as one of the most important process rights available to a tax payer. I will now examine this particular topic and the uncertainty that prevails today in this area though one thought certainty was achieved in the DMS Fernando case.

The Duty to Give Reasons

Giving reasons for one's decision has universally been acknowledged as an aspect of fair hearing. **Certain commonwealth countries long time ago put this duty on a statutory footing.**

Australia imposed this duty in its well known statute-Administrative Decisions (Judicial Review) Act of 1977 (ADJRA).

South Africa has this duty enshrined in its PAJA (Promotion of Administrative Justice Act of 2003).

In contrast, English Administrative Law was quite slow to acknowledge a general duty to give reasons. In addition to the arguments advanced by Lord Justice Sir Harry Woolf (later the Chief Justice of England) in his Hamlyn Lecture called Protection of the Public-a New Challenge in 1989, the major document that set out the reasons for and against giving of reasons in England is called **the All Souls Review of Administrative Law in the United Kingdom**.

Let me summarize the arguments that this document lists out as to why reasons must be given.

Firstly, from the point of view of the functioning of the machinery of government the requirement that reasons be given imposes a healthy discipline on the decision-maker. As a result the quality of a reasoned decision is likely to be much better than one for which reasons were not required. Additionally, the requirement to give reasons acts as a check upon the exercise of arbitrary power and is a fundamental of good administration.

Secondly, the giving of reasons is of relevance from the point of view of the parties affected by the decision. This is because the giving of reasons helps to satisfy a basic need for fair play. Furthermore, it enables a person affected by a decision to know whether the decision itself can be challenged. It should also be noted that, even if the decision is adverse, the person affected may be convinced, as a result of the reasons adduced, that the decision is a rational one beyond the pale of challenge - an unbiased exercise of discretionary power.

Thirdly, the giving of reasons will be beneficial to the reviewing authority. It will expose the thinking of the decision-maker, with the inevitable outcome that it will result in the reviewing authority being in a better position to understand the decision and to exercise any appellate, reviewing or investigatory powers. Advancing proper reasons would expose the possible grounds for judicial review.

Finally, the public at large benefits because if reasons are given it would result in enhancing public confidence in the process of decision-making. Thus, supportable reasons are expected by the public from those who exercise administrative power. This is perhaps the cost one must bear for administration according to law. The absence of a requirement that reasons should be given for a decision is not conducive to the advancement of the rule of law. The giving of reasons is, therefore, a fundamental of good administration.

Argument Against Giving Reasons

The *All Souls Review of Administrative Law in the United Kingdom* has also summarized the arguments, commonly advanced, against the duty to give reasons. It has been pointed out that "efficient administration requires free and uninhibited discussion among decision-makers, unimpeded by considerations of what can or cannot be made public subsequently." Concern has also been expressed that a general requirement that reasons be given for a decision "would impose an intolerable burden on the machinery of government." There are also reservations that the duty to give reasons will result in delays being experienced in the process of decision-making, a "judicialization of affairs" and a lack of candour on the part of the decision-maker.

Nevertheless, it is widely recognized that the giving of reasons is intrinsically desirable and that the arguments in favour clearly outweigh any possible disadvantages.

So what happens if there is a statutory obligation to give reasons and the decision maker failed in this duty? Then we say that the decision maker acted outside the four corners of the legislation and as a result his decision would be ultra vires. Consequently judicial review will lie to quash this decision.

In the context of fiscal legislation you will find this general principle enjoying statutory recognition. Section 163 (3) of the Inland Revenue Act, No 10 of 2006, explicitly provides for a statutory duty to give reasons when a return of income is rejected by an Assessor. This section goes as follows:

> *Where a person has furnished a return of income, the Assessor may in making an assessment on such person under subsection (1) or under subsection (2), either -*
>
> *(a) accept the return made by such person; or*
>
> *(b) if he does not accept the return made by that person estimate the amount of the assessable income, of such person and assess him accordingly:*
>
> *Provided that where an Assessor does not accept the 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.

Section 29 of the Value Added Tax Act, No 14 of 2002 (as amended), also enacts a statutory duty to give reasons in similar circumstances where an Assessor is not going to accept a return. However, this Act also stipulates that the communication of reasons must be effected by registered post – a stipulation not found in the Inland Revenue Act, No 10 of 2006.

It is relevant to recall that section 134 (3) of the Inland Revenue Act, No 38 of 2000, section 115 (3) of the Inland Revenue Act, No 28 of 1979, and section 15 of the Turnover Tax Act, No 69 of 1981, also imposed a statutory obligation to give reasons prior to rejecting a return.

Several Sri Lankan cases have declared a preference for a requirement to give reasons. A noteworthy decision by Justice Mark Fernando is **Karunadasa v Unique Gemstone (1997) 1 Sri LR 256 where the Late Justice Mark Fernando** equated the giving of reasons to protection of persons by law, as contemplated by Article 12 of the Constitution. In the context of tax regime we have the famous trio, as I would call it, of **D.M.S. Fernando v Ismail (1982) 1 Sri LR 222 (SC)**, **New Portman Ltd v Jayawardena (1989) 1 Sri LR 307 (CA)** and **Gunaratna v Jayawardane (1984) Vol IV Reports of Sri Lanka Tax Cases 313 (CA).**

I would now turn to these cases.

D.M.S. Fernando v Ismail (1982) 1 Sri LR 222 (SC)

I have always looked upon this case as laying down certain important propositions of law. In **D.M.S. Fernando** Samarakoon CJ said that judicial review lies against a notice of assessment if a statutory duty imposed upon the assessor has been violated.

In ***Fernando v. Ismail*** Ismail was a taxpayer who furnished a return which was rejected by the Assessor. Prior to the rejection of the return the Assessor had a number of interviews with the relevant taxpayer and the taxpayer was warned that his return would be rejected and an estimated assessment imposed in view of the large sum of money received by him as gross income. The Assessor then proceeded to issue an estimated assessment drastically reducing the amount claimed as expenses. The taxpayer, whilst appealing against the assessment made by the Assessor, sought a writ of *certiorari* from the Court of Appeal to quash the assessment on the grounds that the Assessor had not given his reasons in writing for rejecting the return.

The Court of Appeal granted the relief sought, but the Inland Revenue appealed against the judgment to the Supreme Court. It has to be remembered that it was around 1978 that a provision requiring

assessors to give reasons was put on a statutory footing. So it became a question whether this provision was directory or mandatory.

A five judge bench of the Supreme Court decided, by a majority, that the duty to give reasons in writing was a mandatory provision of law and the failure to do so was fatal; it resulted in a vitiation of the decision of the Assessor to reject the return.

In **D.M.S *Fernando*** the State contended that the taxpayer had furnished a false return; It argued that the reason for the rejection of the return was patent. However, Samarakoon, C.J., expressed the view that falsity was a conclusion arrived at by the Assessor. It was a conclusion arrived at by a process of reasoning based on data available to the Assessor. Explaining the central significance accorded to the duty to give reasons Samarakoon, C. J., said:

*The section requires those **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. 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.*

The judgment of the Supreme Court , was groundbreaking and advances the process rights of tax payers. Two other judges namely Weeraratne J and Wanasundera J agreed with Chief Justice Samarakoon.

Sharvananda, J and Wimalaratne J delivered dissenting judgments. The thrust of their reasoning is that the failure to adduce reasons for the decision did not cause the respondent any prejudice. There was no vitiation of the decision if the assessor did not give reasons.

Justifying his conclusion, Sharvananda, J., said:

In my view, failure to comply with the direction as to communication of reasons, unless it results in injury or prejudice to the substantial rights of the taxpayer, will not affect the validity of the assessment. Disregard by the Assessor of the direction to him to communicate in the end, after his assessment, the reasons for not accepting the taxpayer's return does not, ipso facto, render void or nullify the antecedent assessment made under section 93 (2) (b). It only makes the assessment voidable if the taxpayer is substantially prejudiced by such disobedience. The taxpayer, however, has the right to call for reasons at any time.

The articulations of the minority are not entitled to much weight in the light of the mandatory obligation that has developed today to provide reasons and the majority opinion in **DMS Fernando** was echoed in the same breath in the subsequent case of ***New Portman Ltd v. Jayawardene***

***New Portman Ltd v. Jayawardena* (1989) 1 Sri LR 307**

In the *New Portman* case, the Assessor rejected the return on the basis that the statement of accounts, which accompanied the return, was false. The Assessor who purported to reject the return communicated in the following terms-"According to the information available to me, the statement of accounts furnished by you in support of the return of income ..does not reveal the correct profits. I am therefore rejecting your return…." According to Thambiah, J., this was only a conclusion and not reasons for such a conclusion. The Court said that this does not amount to communication of reasons as required by the Statute.

Thus you would see if the Assessor rejects a return, without communicating the **reason f**or doing so, he would be acting ultra vires. Communication of conclusion does not satisfy the mandatory requirement.

Both cases-**D.M.S. Fernando and New Portman** unequivocally declare that reasons are a sine qua non and a breach of the duty results in the assessment becoming null and void.

This certainty seems to have become uncertain by undue and excessive weight being placed on another decision which was decided on the same day as New Portman. I of course refer to the Court of Appeal decision ***Guneratna v Jayawardane*.**

***Guneratna v Jayawardane* Ceylon Tax Cases Volume IV 246**

The complaint against the assessor was that the letter that conveyed the reason for rejection was not a reason at all. The letter said that the assessee had not disclosed his income from some lorries. Tambiah J (later the Chief Justice of this country) who on the same day decided New Portman held in this case that the Assessor had made a sufficient disclosure of reasons for the non-acceptance of the return of the taxpayer. The learned judge stated that **a clue** had been given to the taxpayer to enable him to know where he had gone wrong in his return.

No doubt Guneratne stated that giving a clue was sufficient. But if the Department of Inland Revenue as well as the Board of Review entertain the view that a clue would at all times amount to a reason I would disagree. Justice Tambiah spoke about a clue only after having stated the general proposition in New Portman. In ***Guneratne*** he was only echoing an exception to the general rule that reasons must always be given for rejecting a return. He was stating an exception because the special circumstances of the case (the tax payer suppressed the income derived from lorries) justified giving of a clue that left the tax payer in no doubt as to why his return was getting rejected. But **Guneratne d**oes not lay down a uniform proposition that giving a clue would be sufficient at all times.

It is a serious and erroneous mistake if any one thinks that giving a clue would be tantamount to a discharge of the imperative duty to provide reasons. If this misconception is permitted to be continued, we would only be derogating from due process and fair procedure that does not augur well for the protection of tax payers' rights.

Having dealt with how uncertainty is engendered because we misread cases let me take you to **another aspect of D.M.S. Fernando** which is worthy of mulling over on an annual oration such as this.

Alternate Remedy Objection

When the case was being argued in the Supreme Court, an interesting objection had been raised on behalf of D.M.S.Fernando to the maintainability of the writ application. Usually judicial review is objected to if there is an efficacious alternate remedy available to a party. So it was argued by the Attorney General's Department that since there was the remedy of appeal to the Commissioner General that was available to Ismail, he could not maintain the writ application. Samarakoon CJ made short shrift of this argument.

The Learned Chief Justice stated that you can raise the breach of statutory duty by a writ of certiorari. **He widens the scope of the remedies by paving the way for a writ to lie.** But nowhere did the Learned Chief Justice suggest that judicial review is the one and only remedy for non disclosure of reasons.

Nobody can argue that non disclosure of reasons or a breach of statutory duty cannot be taken up before the Commissioner General in the appeal.

There is a tendency today to hold out D.M.S.Fernando as representing the position that non disclosure of reasons can be taken up as a ground only in the Court of Appeal. I disagree with that proposition which D.M.S.Fernando did not put forward.

Thus you see what is laid down as certain propositions of law can be misinterpreted and used even by the Department of Inland Revenue leave alone by practitioners. Anyone can get the interpretation wrong. None is infallible as we are prone to make mistakes.

But what puzzles me is the recent innovation-section 204A of the Inland Revenue Act No 22 of 2011 which permits a prosecution of auditors and tax practitioners before a Magistrate for **deliberate misinterpretation** of any provisions of the Act.

One finds no definition of the phrase **deliberate misinterpretation in the Act** and as each statutory offence today has to be established beyond reasonable doubt, the mens rea or the guilty mind of the auditor and practitioner –i.e he gave a willful misinterpretation of a provision - has also got to be proved beyond reasonable doubt. To any prosecution of a statutory offence there lies a defence of good faith and certainly the chapter on general exceptions in the Penal Code of this country is bound to provide a defence to those hapless auditors and tax practitioners if they have the misfortune of being hauled up before a Magistrate. What if two constructions are possible, one in favor of the Assessee and the other in favor of the Assessor? Did not that learned Judge Tambiah J state in ***Mohamed v Commissioner of Inland Revenue*** (Sri Lanka Tax Cases Volume III, at 178) that if two constructions are possible, the Court must adopt the construction which is favorable to the assessee?

Thus you will see that the auditors and tax practitioners will have a slew of defences which will render a prosecution nugatory. Just as much auditors and tax practitioners can get it wrong, so can the Department of Inland Revenue. Is it an impossibility for someone to argue that there is willful misinterpretation in the way the Department of Inland Revenue has sought to interpret a particular provision?

That is why we must call for an abolition of this provision which does not make any sense.

As regards appeal procedure I will touch on the Tax Appeals Commission as the audience is well aware of the appellate mechanism before the Commissioner General.

Tax Appeals Commission

The Tax Appeals Commission Act, No 23 of 2011 (as amended) establishes the Tax Appeals Commission. The Board of Review ceases to exist under this Act, but in respect of appeals that were heard before it, the provisions relating to the Board of Review remain relevant.

Whilst the attempt to set up an impartial first tier tax appeal tribunal must be lauded, the legislative effort leaves in certain respects much to be desired.

The Tax Appeals Commission is required to comprise a retired judge of the Supreme Court or Court of Appeal and two other persons who have garnered eminence in the fields of taxation, finance and law. Are these domains of expertise conjoint or disjunctive? The legislation gives no answer. Tax Appeals Commission has commenced work and one hopes that it will be a robust body displaying a sensitivity to its statutory functions far superior to that of its predecessor.

The Act also makes provision for the Minister of Finance to appoint a panel of not more than ten **Legal Advisors**, who have gained eminence in the field of law, to assist the Commission in its work. Three or

more members of the panel shall be nominated by the Minister to attend appeal hearings of the Commission. The enactment does not require that a Legal Advisor should be a licensed practitioner in Sri Lanka. Therefore, it is possible for Legal Advisors to the Tax Appeals Commission to be practicing lawyers, academics or jurists provided that they have gained eminence in law – albeit not in the field of taxation.

Procedure of Appeal

Where a person is aggrieved by a determination of the Commissioner General of Inland Revenue, such a person must notify the Tax Appeals Commission, **within thirty days** from the date of the said determination, that he intends to prefer an appeal to the Commission. When such notification is given, the Commission must inform the Commissioner General of Inland Revenue and require him to transmit in writing **his reasons** for the determination within a period of thirty days from the date of receipt of the notification.

The reasons for the determination by the Commissioner General of Inland Revenue must be transmitted to the Tax Appeals Commission, the aggrieved party and his authorized representative.

Validity of Appeal to the Commisison-25% of the Sum assessed as deposit

The proviso to invoking the right of appeal is that , the appellant must deposit into a special account either twenty five percent of the tax assessed (excluding any penalty) or a bank guarantee for the equivalent amount.

This requirement can be criticized because it can be very unfair to a taxpayer who has received an arbitrary and grossly unfair assessment which has been rubber stamped by a determination of the Commissioner General of Inland Revenue. Though bank guarantee is an alternative to legal tender, there is a cost to it and it impairs the borrowing power of the assessee.

The Act does not give the Tax Appeals Commission the power to refund the amount paid if such payment is not due after the determination of the appeal. The Commission also has no power to transfer funds to the credit of the Commissioner General of Inland Revenue or to the credit of the Consolidated Fund. The Act does not specify how funds collected in the special account must be appropriated by the Tax Appeals Commission. In the event that an appellant elects to furnish a bank guarantee, the Act does not specify

who should be the beneficiary of such a bank guarantee, the tenor of the bank guarantee and whether it should be revocable or irrevocable.

Hearing before the Commission

It is important to note that **within thirty days from the date of receipt of an appeal,** the Secretary to the Tax Appeals Commission must **fix a date and time for the hearing of an appeal** and to provide forty two days notice of the same to the appellant and the Commissioner General. What if there is a breach of this statutory duty? The Act provides no answer.

Section 9 (5) of the Tax Appeals Commission Act states that the onus of proving that an assessment, as determined by the Commissioner General of Inland Revenue, is excessive or erroneous shall be on the appellant. The general rule is that evidence that was not adduced before the hearing by the Commissioner General of Inland Revenue cannot be produced before the Tax Appeals Commission but an exception is provided to enable such evidence to be led with the permission of the Commission.

After hearing the evidence the Commission is empowered to confirm, reduce, increase or annul the assessment as determined by the Commissioner General of Inland Revenue or remit the case to the Commissioner General of Inland Revenue with the decision of the Commission on such appeal.

The Commission is obliged to make its decision in respect of any appeal within two hundred and seventy days from the date of commencement of the hearing of the appeal whilst appeals transferred from the Board of Review must be determined within twelve months from the date on which the Commission began sittings.

There is also provision for the Commission to order costs, capped at Rs 5000/-, in circumstances where the assessment appealed against is not reduced or annulled by the Commission. This sum could be added to the tax charged and recovered. So much for the Tax Appeals Commission.

Appeals to the Court of Appeal and to the Supreme Court.

The second tier appeals contemplated by the Inland Revenue Act, No 10 of 2006 (as amended), and other similar taxing statutes provide for an appeal on a question of law to a the Court of Appeal which could be followed by an appeal to the Supreme Court.

The Act makes provision for an appellant or the Commissioner General of Inland Revenue to make an application to the Tax Appeals Commission to **state a case on a question of law** for the opinion of the Court of Appeal. Once the stated case is prepared by the Tax Appeals Commission and sent to the party

who requested a stated case the obligation to transmit it to the Court of Appeal lies on the said party. Any two or more judges of the Court of Appeal are empowered to hear and determine any question of law arising on a stated case. The Court is empowered to give effect to its decision on the questions of law and to confirm, reduce, increase or annul the assessment as determined by the Tax Appeals Commission.

Alternatively, the Court may remit the case to the Tax Appeals Commission with the opinion of the Court thereon. In such an eventuality the Tax Appeals Commission is bound to revise the assessment in accordance with the decision of the Court.

A party who is dissatisfied with the decision of the Court of Appeal may appeal therefrom to the Supreme Court on the basis that the decision represents a final judgement of the Court of Appeal in a civil action. For this purpose a party must seek special leave to appeal to the Supreme Court on a question of law. It is only if such leave to appeal is granted that the Supreme Court will consider and give a judgment on the question of law raised.

Thus the focus of my attention has been how the cases, some of which are seminal, are misinterpreted and misunderstood. This kind of exercise may have far reaching impact on an important stakeholder such as the tax payer severely eroding his rights. No doubt the state needs an efficient and effective mechanism to collect revenue for otherwise a welfare state cannot exist without taxation. Be that as it may, the imposition, administration and enforcement of tax obligations have the potential to raise questions about the rule of law.

These functions can intrude on the rights of tax payers while we acknowledge that taxation constitutes an important component of economic justice.

In this process let us recall what Liam Murphy and Thomas Nagel, state in reference to economic justice in political theory (in the context of taxation).

> *Taxes are part of that structure, but they have to be evaluated not only as legal demands by the state on individuals but also as contributions to the framework within which all those individuals live.*

You annual orations give strength and sustain the participatory mechanism we solely need to sensitize people to tax law and jurisprudence and I certainly feel proud that I was part of that participatory democracy today.

Thank You