The Law Relating to Assessments

Stanley Fernando

In any year of Assessment all those liable to income tax are called upon to make their payments or file their Returns before the due date. But how do assessment laws work in each and every tax payers case. Stanley Fernando highlights some important laws relating to assessment under the Inland Revenue Act.

Self-Assessment- Section 97- of Income Tax Inland Revenue Act.

The applicable law is contained in section 97 of Act 28 of 1979. Section 97(1) requires any person liable to pay Income Tax in any year of assessment to pay such tax in 4 quarterly installments on or before 15 May of the next succeeding year of assessment, notwithstanding that no assessment has been made by an Assessor. The quarterly installment of a tax payable by any person for any year of assessment shall be one-quarter of the tax payable by him for that year of assessment.

The term ‘Self-Assessment’ is a misnomer. The term is more indicative of a method of tax collection than of assessment. There is nothing in this provision which requires the assessee to assess himself. Nor is such a method of assessment practical or possible. All that the section requires is that any person liable to pay income tax must pay 4 quarterly installments of the tax payable by him for that year of assessment notwithstanding that an assessor has not assessed him to any tax. The “tax payable” by him at the most can be an estimated sum.

Assessments Under The Inland Revenue Act. Assessment of tax- Section 115(1)

Section 115(1) empowers an Assessor to assess any person who in his opinion is liable to income tax for any year of assessment who has not paid the full amount of the tax for which he is liable or paid less than the proper amount of tax which he ought to have paid, after the 15th November of the succeeding year of assessment. The Assessor must by notice in writing require such person to pay forthwith the full amount of tax underpaid. However an Assessor may make such an assessment of tax before 15th November of the next succeeding year of assessment if he is of the

opinion that such person is about to leave the country or that it is expedient for the protection of the revenue, and require such person to pay such tax earlier than is required under the scheme of self-assessment.

Assessment of additional amount of Income- Section 115(2)

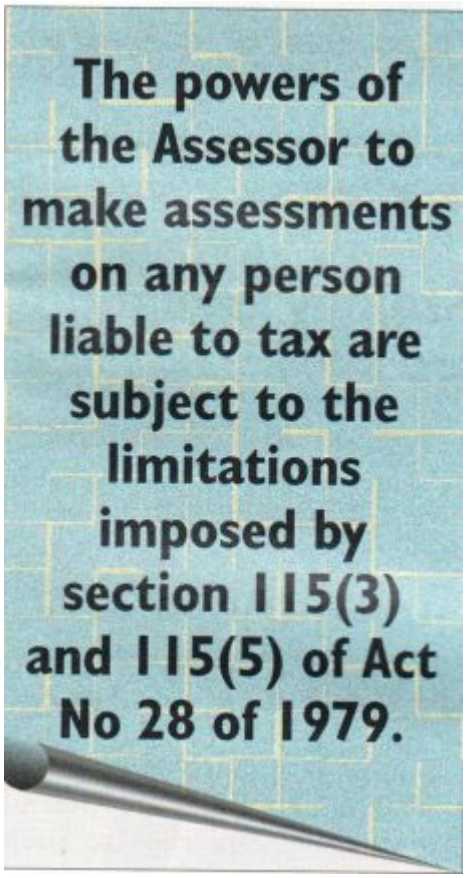
Section 115(2) empowers an Assessor to assess any person liable to income tax for any year of assessment on any additional amount of income on which he ought to have been assessed. This provision enables an Assessor to make an assessment of income in addition to what the assessee has returned or in addition to what he has already been assessed on.

Limitations on the Power of the Assessor to make Assessments

The powers of the Assessor to make assessments on any person liable to tax are subject to the limitations imposed by section 115(3) and 115(5) of Act No 28 of 1979.

Section 115(3) of Act No 28 of 1979.

This provision, first enacted by Amendment Law No 30 of 1978 as section 93(2) of Inland Revenue Act No 4 of 1963 was re-enacted



as section 115(3) of Inland Revenue Act No 28 of 1979. Section 115(3) is one of the most progressive and enlightened enactments which are designedly legislated for the protection of the taxpayer against the arbitrary and capricious exercise of statutory power by the Revenue. Section 115(3) 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 section 115 (1) or section 115(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 he

shall communicate to such person in writing, his reasons for not accepting the return".

In the land-mark case of Mrs D MS Fernando, Assessor vs Ameer Mohideen Ismail, (1982) 1 Sri LR 222, Neville Samarakoon CJ laid down the following principles in interpreting section 115(3) cited above.

(i) Section 115(3) is a mandatory provision of law, noncompliance with which renders an assessment ultra vires and void ab initio.

(ii) If the Assessor decides to reject the return of a taxpayer, it is mandatory for the Assessor to communicate to the taxpayer his reasons for not accepting the return.

(iii) The reasons must be communicated in writing before or at the time the Assessor issues the assessment.

(iv) A conclusion of the Assessor is not a reason. For example, bald statements such as the following do not communicate reasons. "Your return is rejected for the following reasons:

i) Your statements of accounts are not satisfactory.

ii) The income declared by you is not commensurate with your investments."

(v) Reasons must be communicated in all cases without exception, even in a case where the assessee, as in Ismail's case, has admitted that his return was a false return and even where the asses- see has agreed to be assessed on additional income. An assessment bearing the legend such as "as per agreement of 1.1.92" is not a valid assessment, if reasons have not been given for rejecting the tax payer's return.

(vi) Reasons must disclose to the taxpayer the Assessor's thinking and the Assessor's reasons for not accepting his return, although the Assessor is not required to communicate the reasons for or the basis of his assessment. Even obvious reasons must be communicated.

Section 115(3) and its interpretation by the supreme court in Ismail's case is a milestone in the history of taxation in Sri Lanka. As Dr G L Peries has remarked in his Ambalavaner Memorial Lecture, 'the most important application of the vires principle to taxpayers in Sri Lanka undoubtedly finds its setting in section 115(3) of

the Inland Revenue Act.’ Besides being a protection against arbitrary and capricious exercise of discretionary powers by tax men, the obligation to communicate reasons enables a taxpayer to know and understand the basis of an additional assessment and to proffer specific and adequate grounds of appeal against the Assessor’s assessment. More importantly, non- compliance with section 115(3) by the Assessor enables a taxpayer to seek his remedy by way of a writ of Certiorari to have the assessment quashed as was done in the Ismail case and New Portman Ltd vs Jayawardena. The validity of an assessment for contravention of section 115(3) can even be raised in recovery proceedings for taxes in default, as there is no tax in default if the assessment is void ab initio for non-compliance with section 115(3).

Section 115(5) reads as follows:- “Subject to the provisions of Section 62, no assessment shall be made-

(a) of

(i) income tax or wealth tax payable under this Act, for any year of assessment commencing before April 1, 1986, by any per- son, or

(ii) any gifts tax, payable under this Act, by any person in respect of any gift made by him in any such year of assessment but before November 13, 1985 and included by such person in a return made by him on or before the thirtieth of November next succeeding that year of assessment, after the expiry of three years from the end of that year of assessment

(b) of the income tax or wealth tax, as the case may be, payable under this Act for any year of assessment, commencing on or after April 1. 1986 by any person who has made a return of his income or wealth, as the case may be, on or before the thirtieth of November next succeeding the end of that year of assessment,

after the expiry of three years from the end of that year of assessment; and

(c) of the income tax or wealth tax, as the case may be, payable under this Act for any year of assessment, commencing on or after April 1, 1986, by any person who has made a return of his income or wealth, as the case may be, on or before the thirtieth of November next succeeding the end of that year of assessment, but on or be fore the thirty-first day of March in the next succeeding year.

After the expiry of five years from the end of the year of assess ment in which the

return is made:

Provided, that nothing in this subsection shall apply to the assessment of income tax payable by any person in respect of any year of assessment, consequent to the receipt by such person, of any arrears relating to the profits from employment of that person for that year of assessment:

Provided further that, where in the opinion of the Assessor any fraud, evasion or wilful default has been committed by, or on behalf of, any person, in relation to any income tax, wealth tax or gifts tax payable by such person for any year of assessment, it shall be lawful for the Assessor to make an assessment or an additional assessment on such person at any time after the end of that year of assessment."

Section 115(5) imposes a time- bar on the Assessor's power to make assessments. The Inland Revenue Act No 4 of 1963 allowed an assessment or additional assessment in respect of any year to be made during that year of assessment or within 6 years from the end of that year. This was reduced to 3 years by Inland revenue act No 28 of 1979. Amendment Act No 56 of 1985 made a further change by restricting the limitation of 3 years only to persons who had furnished their returns on or be fore the 30th November of the year succeeding the year of assessment after the expiry of 3 years from the end of that year of assessment. By amendment Act No 8 of 1988 the Assessor is empowered to make an assessment after April 1, 1988 after the expiry of a period of 5 years if the return has not been made after 30th November of the year succeeding the year of assessment, but on or before 31 March of the next succeeding year.

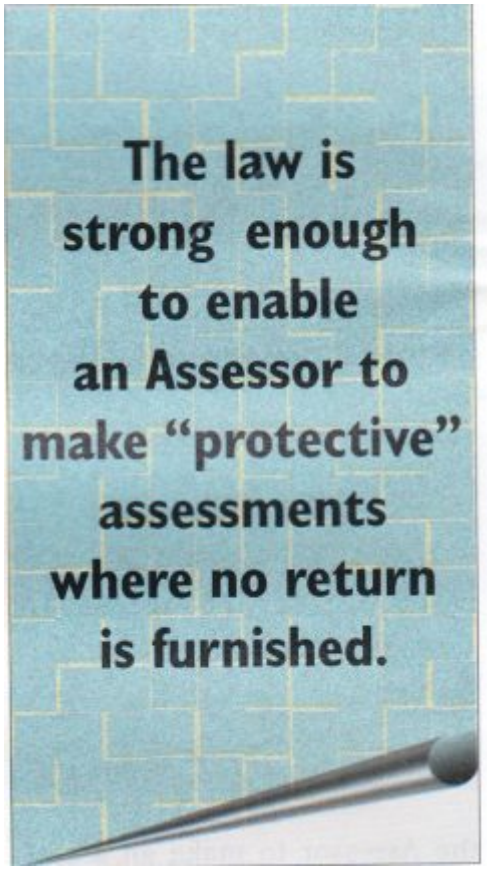
The relaxation of the rule of prescription in favor of the Revenue is a confession of the failure of the Revenue to make lawful assessments within the prescribed period. The law is strong enough to enable an Assessor to make "protective" assessments where no return is furnished. Further there is a confiscatory fine up to a maximum of Rs 50,000 for failure to furnish a return. These recent amendments cutting into the plea of prescription as a legal defense to fiscal liabilities tend to make tax law harsh and oppressive.

Exceptions to the Limitation Rules

The above rules of prescription do not apply to the assessment at any subsequent time of arrears of profits from employment received for any year of assessment.

The purpose of this exception is to permit taxation of income which has accrued within an year of assessment as income received within the same year. For example increments payable but not paid in 1980, but only received by the employee in 1990 can be taxed in 1991, notwithstanding the time- bar of three years.

Proviso 2 of Section 115(5) makes it lawful for an Assessor to assess any person for any year of assessment at any time notwith

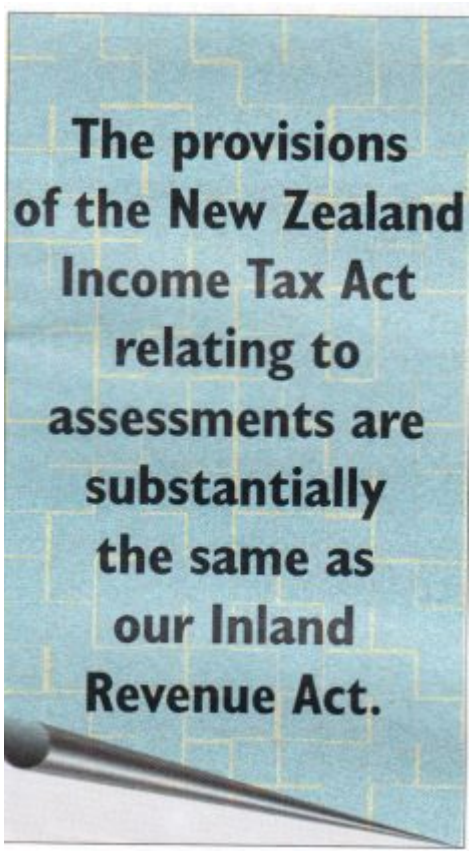


standing the time-bar of three years, if the Assessor is of opinion that any fraud, evasion or wilful default has been committed by or on behalf in relation to any income tax.

This provision of law was enacted in the Income Tax ordinance and the Inland Revenue Act No. 1963 as follows:- "Provided that where the non- assessment or under-assessment of any person for any year off assessment is due to fraud or wilful evasion, such assessment or additional assessment may be made at any time after the expiration of that year of assessment."

This provision of law was rather vague and amorphous, and was amended by Section 12 of Amendment Act No 43 of 1983 as follows:-

“Provided further that where in the opinion of the Assessor, any fraud, evasion or wilful default has been committed by, or on behalf of, any person in relation to any income tax payable for any year of assessment, it shall be lawful for



the Assessor to make an assessment or an additional assessment on such person at any time after the end of that year of assessment.”

The power conferred on an Assessor to make out-of-time as sessments is objectionable for two reasons.

(i) The new amendment does not specify the date from which it becomes operative. The Revenue will claim that it operates with retrospective effect. But retrospective legislation is repugnant to tax legislation, particularly if such legislation does not specify the date from which the legislation is operative and more particularly if such retrospectivity affects vested rights.

(ii) The power to make out of time assessments based on an Assessor's subjective opinion that the taxpayer has committed fraud, evasion or wilful default is too important a matter to be left to the subjective whims of an Assessor, as such an assessment is fraught with serious repercussions to the tax- payer including penal sanctions. It is important to note that in the British Tax Law the Inspector of Taxes (the British counterpart of the Assessor in Sri Lanka), is not vested with such untrammeled discretionary powers. The Inspector can issue out-of-time assessments based on fraud and wilful default only after obtaining the approval of the Special Commissioners. A similar safe- guard is provided for in Indian Tax Law. It is submitted that the present law, (cited above) should be amended for out-of-time assessments to be personally approved by the Commissioner-General or a Commissioner and that the Assessor be required to communicate to the assessee the reasons for his opinion that the Assessee had committed fraud, evasion or wilful default.

Assessments in the absence of returns-Section 115(4)

Section 115(4) of Inland Rev- enue Act No 28 of 1979 Provides as follows:-

"Where a person has not furnished a return of income and the Assessor is of the opinion that such person is liable to pay income tax, the Assessor may in making an assessment on such person under section 115(1) or section 115(2), estimate the amount of the assessable income of such person and assess him accordingly, but such assessment shall not affect the liability of such person to a penalty under this Act for failure or neglect to furnish a return."

This is an enabling section which empowers an Assessor to make estimated assessments on any person for any year of assessment who fails too furnish a return. But the section stipulates that the Assessor must first form the opinion that such person is liable to pay income tax for that year of assessment. This is a condition precedent to the issue of an estimated assessment in the absence of a return. In Argosy Co. Ltd vs Inland Revenue commissioner (Guyana) 1971 W.L.R., April 2, 514 the Privy Council interpreted section 48(4) of the Income Tax Ordinance of Guyana which was substantially similar to section 115(4) of the Sri Lanka Inland Revenue Act No 28 of 1979, provided as follows:-

"Where a person has not delivered a return and the Commissioner is of the opinion that the person is liable to pay tax, he may according to the best of his judgment, determine the amount of the chargeable income of that person and assess him

accordingly.”

The facts of this case were as follows:- The taxpayer company failed to submit an income tax return for the year of assessment 1962, because all the books of the company were destroyed by fire in a riot in February 1962. The company had made trading losses in the two previous years and had a total of 8 62, 344 carry-forward losses. The commissioner assessed the company to income tax in the sum of $25,000 on an estimated basis under section 48(4) of the Income Tax Ordinance. The company objected on the ground that before the commissioner could make an assessment “to the best of his judgment,” he first had to form an opinion that the person was liable to tax and that was untenable in the circumstances of the case. This objection was upheld by the Board of Review, but over-ruled by the single judge of the Supreme Court whose judgment was affirmed by the Court of Appeal. On appeal to the Privy Council it was held allowing the appeal, that the right of the commissioner to make an estimated assessment under section 48 of the Income Tax Ordinance never arose, because of the facts of the case he could have formed no reasonable opinion that the company was liable to income tax for the year of assessment 1962 owing to the large carry-forward losses which would have to be set against its chargeable income. The assessment was annulled.

When is an assessment made?

In the New Zealand case of Lloyd’s Bank Export Finance Ltd vs C.I.R. (New Zealand) the Privy Council held as follows:-

(i) When the process of determining the assessable income was complete an assessment had been made irrespective of whether the amount on which tax was payable produced by that process resulted in a positive figure, a nil figure or negative figure.

(ii) The Commissioner’s determinations that no tax was payable for 1976 and 1977 constituted “assessments”

(iii) The Commissioner was time-barred from increasing the assessments already made under section 25, New Zealand Income Tax Act 1976.

The provisions of the New Zealand Income Tax Act relating to assessments are substantially the same as our Inland Revenue Act. This judgment is important in relation to the following important question:-

When is an assessment final and conclusive?

An assessment is final and conclusive for all purposes of the Act as regards the amount of such assessable income in the following circumstances:-

(i) Where no valid appeal has been lodged against an assessment as regards the amount of the assessable income

(ii) where an appeal preferred against such an assessment is dismissed under section 117(7)

(iii) where agreement is reached under section 117(5) as to the amount of such assessable income

(vi) where the amount of such assessable income has been determined on appeal.

Exception to the above rules Section 123 of Act No 28 of 1979

An Assessor is not precluded from making an assessment or additional assessment for any year of assessment, notwithstanding the above rules, if such an assessment does not reopen any matter which has been determined on appeal for that year.

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