

A Critical Appraisal of some Aspects of Income Tax

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In the current context of economic development when the country is undergoing rehabilitation after a three-decade-long conflict and poised for an economic take-off, the issues of taxation and fiscal policy take on added importance. Taxes in Sri Lanka finance 65 per cent of the government's expenditure and lending, and in the context of a declining tax ratio to GDP (Gross Domestic Product) in recent years, the issues involving current taxation, particularly in income tax which brings in about 20 per cent of tax revenue or around 3 per cent of GDP, assume crucial significance.

This book, written by a former Deputy Commissioner of the Inland Revenue Department, therefore, is timely and consists of a collection of essays dealing with both tax policy issues and tax administration using his wide knowledge of the subject and experience in administering income tax in the Department.

Commencing with a description of the historical background of taxation, the author goes on to discuss issues such as tax avoidance and evasion, tax amnesties, some issues argued in several tax cases in Courts, a critical analysis of various administrative aspects of taxation including raids and penalties, relations between the tax authorities and the taxpayers and includes a historical perspective of tax administration in Sri Lanka from 1932 to 2007.

These issues discussed, both policy and administrative, assume importance as they figure in the current attempts at reforming the taxation system by the Presidential Taxation Commission of 2009. This

point has been emphasised in the Foreword in the book written by a member of the Commission, Dr. Saman Kelegama.

In all these relevant issues discussed in the book, the author has been forthright enough to express his own views boldly, and as the title of the book indicates, it is critical appraisal of the issues discussed. As the Foreword states, "the author has not hesitated to be extremely critical where necessary, and has spared neither his department, colleagues, eminent tax lawyers and practitioners nor even some judgements of the Appeal Court and Supreme Court.

The book commences with a brief introduction to the subject of taxation giving a historical background as well as the basic principles that govern a tax structure where he discusses the relevant principles enunciated by Adam Smith in his "Wealth of Nations". This includes the broad classification of taxes into direct and indirect taxes and the fundamental principles of equity and progressivity which characterise a proper tax structure.

This is followed by a discussion of tax amnesties granted by successive governments in Sri Lanka with monotonous regularity. Here, the author takes issue with a prominent Chartered Accountant and tax consultant regarding the reasons attributed for the failure of tax amnesties. The Chartered Accountant took the view that the amnesties failed for two reasons:

- (i) that in the year of amnesty, evaded taxes were not in cash but in business, property and assets,
- (ii) that people did not have trust and confidence in the tax administration.

The author disagrees and takes the opposite view. On the first, he points out that a significant percentage of declarations was in fact in cash, and on the second, he states that it was precisely because tax evaders had nothing to fear in declaring that they took advantage of the amnesties in 1989 and the 1990s.

The discussion on tax amnesties is connected with two other relevant issues, tax avoidance and tax evasion, in Chapters IV and VIII of the book. Tax avoidance and evasion, though interconnected, are two different things legally. Tax avoidance takes place within the legislative framework where a taxpayer takes advantage of the loopholes in the law and the maximum advantage of the legislative provisions to minimise his tax liability. Tax evasion, on the other hand, is the total avoidance of tax liability by not adhering to the legal provisions of the tax laws. The author points out that, today, the drafting of tax avoidance schemes has become a big industry, and thus, a big problem to Inland Revenue authorities the world over. The Courts which were initially responsible for this, have now come out strongly against such schemes. In this respect, the author discusses the significance of the United Kingdom tax cases, *Duke of Westminster vs Commissioner of Inland Revenue (CIR)* which endorsed the taxpayer's entitlement to the letter of the law, and the subsequent cases of *Ramsay vs CIR*, *CIR vs Burmah Oil Co.* and *Furniss vs Dawson*, came out strongly against tax avoidance schemes.

In respect of tax evasion, the author in Chapter VIII reviews a Sri Lanka tax case of Merrill J. Fernando & Co. vs H.B. Gunadasa and others, where he respectfully disagrees with the judgements given by the Court of Appeal and the Supreme Court when they held that the taxpayer was guilty of tax evasion. The author is of the contrary view that where the taxpayer had not concealed the primary facts, he cannot be accused of tax evasion.

The author's trait of having confidence in his own judgement and disagreeing with those of others is again manifested in Chapter V where he reviews an article by a leading attorney-at-law and tax consultant on the legal issues in tax investigations. The author disagrees with the tax lawyer on a number of matters. These include such issues as (i) the nature of tax investigation (ii) more appropriateness of judicial review than case-stated procedure (iii) the circumstances in which a taxpayer should move for a Writ of Certiorari (iv) the legality of seizing documents in the course of a Revenue Raid, etc.

The issue of Revenue Raids itself is specially gone into Chapter VI which discusses the powers of the Inland Revenue authorities in respect of entry, search and seizure. It deals with such issues as the effect a raid has on the party searched, the concept of Public Interest, the seizure of documents and other evidence, the effect on third parties, the evidence obtained on the basis of illegal search and the concept of Legal Professional Privilege.

On tax administration, the book covers many areas such as the penalties for incorrect tax returns, the relations between the Tax Department and the tax-paying public, the issue of establishing a Revenue Authority and a historical review of the Department in its 75 years of existence from 1932 to 2007.

Chapter VII which deals with penalties for incorrect returns

discusses a number of issues such as on whom is the onus of proof, the standard of proof, the concepts of fraud and wilful neglect, penalty mitigation, appeals against penalty and whether penalty provisions have attained their objective.

In respect of relation between tax authorities and tax-paying public which is crucial for securing a good compliance rate, the author maintains that except at the very early stage, the relations between the two have not been cordial. Initially, this was due to the lapses of the tax-paying public and eventually to the attitude and conduct on the part of the department. Overall, according to the author, the department must accept a greater responsibility for the breach of good relations between the department and the tax-paying public. Perhaps the tax officers of the department will probably dispute this view.

Many attempts have been made to minimise the defects in tax administration and improve the efficiency of the various units and branches of the Department. Such measures include procedural improvements, computerisation, training, performance incentives, establishment of a closed service, etc. In this context, one view was the establishment of a Revenue Authority. The author, however, disagrees with this as a panacea for the problems within the departments, and maintains that the problems within should be addressed and rectified rather than imposing a superstructure on the revenue departments.

Finally, the author traces the performance of the Tax Department during its seventy five years from 1932 to 2007. As stated in the Foreword to the book, the author has followed Dr. Gamani Corea's advice to follow up his earlier history of the Department up to 1957 by recording the events to the present day. He has done this in the present volume although in lesser detail. This chapter contains a whole lot of statistics regarding assessments, collection data, arrears, taxes in default, etc. as well as details of the human

resources and staff in the Inland Revenue Department and includes an Organisation Chart as at 31.12.2006 as well. However, his judgement is that overall (except for the period 1963-1977), the department has failed to achieve its primary functions of tax collection and combating tax evasion.

There are however some points an earnest reader may ponder on. One is that the issues discussed in various chapters may sound too technical and legal to the general reader interested in taxation, and particularly to the tax-paying public. Some issues may also appear to be outdated and irrelevant in the current context. However, such technicalities cannot be avoided in discussing a subject as taxation due to its very nature. Another point is that some may disagree with the author's viewpoints and contentions on a number of controversial issues and tend to agree with his adversaries. Finally, some may view the vehemence with which the author has expressed his disagreements on various issues with reputed Chartered Accountants, tax lawyers and tax practitioners and even with respected judges of the Appeal Court and Supreme Court, as too harsh and even incorrect. The reviewer, being a fellow student of the author in the Peradeniya Campus in its halcyon days and also a colleague in the Inland Revenue Department is familiar with the author's thinking on these various issues, and hence, is not surprised on the controversial nature of the views expressed in the book.

Nevertheless, overall, the book is an extremely useful source of information with thought-provoking discussions on a number of issues written in a lucid and readable style resulting from the author's long experience in tax administration. It would be an interesting and useful reference material for scholars, administrators, policymakers, tax administrators and the tax-paying public alike.

A Stamford Lake publication, the book is available for sale at the Lake House Bookshop and other leading booksellers. ■