1987 March 13

[A LOIZOU MALACHTOS SAVVIDES PIKIS KOURRIS JJ]

STAVROS GEORGHIOU

Appellant - Applicant.

v

THE REPUBLIC OF CYPRUS THROUGH THE COMMISSIONER OF INCOME TAX,

Respondents
(Revisional Jurisdiction
Appeal No 675)

Income tax — Deductions and allowances — Bad debts — The general principle emanating from the authorities — The nexus that must exist between a bad debt and the income from which it is sought to deduct it — Professional man — Need for express finding that the loss was incurred in the course of carrying his profession — Loss of money lent — Principles governing its deductibility — The Income Tax Laws 1961-1977 section 11(1)(c)

Income tax — Deductions and allowances — The Income Tax Laws 1961 - 1979 — Section 15 — Ambit of

Words and phrases «Profession» and «incurred in any» in section 11(1)(c) of the Income Tax Laws, 1961 - 1977

The appellant, who comes from Famagusta and who, before the Turkish invasion, exercised in that town on his own his profession as accountant and auditor, lent, at some time before the Turkish invasion the sum of £15,000 to a family company, for the purpose of enabling the latter to run its hotel business

The property owned by the said company is situated in an area occupied by the Turkish invasion forces, whilst the appellant and his family moved as refugees in Nicosia

The appellant challenged by means of a recourse the decision of the respondent Commissioner, whereby the latter rejected appellant's claims for relief for income tax purposes in respect of the years of income 1975 and 1976 for the loss of the £15,000 lent to the said company

The recourse was dismissed by a Judge of this Court (See Georghiou v The Republic (1986) 3 C L R 1755) on the ground that the amount o £15,000 was capital invested in another enterprise outside the usual course of

of appellant's profession and, therefore, not an expense wholly and exclusively incurred for the production of appellant s income from his profession

Hence the present appeal Counsel for the appellant argued that the word «profession» in section 11(1)(c) of the Income Tax Laws, 1961-1977 gives a different context to this provision as compared with the corresponding provisions in the English Tax Legislation and that the trial Judge wrongly did not decide the case within the ambit of section 15 of the Income Tax Laws 1961-1979

Held, dismissing the appeal (A) Per A Loizou, J , Malachtos, Savvides and Kourris, JJ concurring (1) On the authorities as they stand the general principle is that «no sum can be deducted in respect of any loss which is not connected with or does not arise out of the trade A loss that is incurred in a transaction entered into for the purpose of earning the profits of the trade is permissible deduction the question whether in any particular case the loss arose out of, or in connection with the trade is a question of fact» (Simon's Taxes, 3 Edition Vol B page 630 para B1 1305)

(2) The presence of the word «profession» in section 11(1)(c)* of the Income Tax Laws, 1961-1977 does not help the appellant inasmuch as the «Bad Debt» eligible for deduction must have been incurred in respect of the profession of the taxpayer and not independently of it It is as in the case of a «bad debt» of a trader which must be connected with his trade The material words in the section are «incurred in any» which means in respect of or in connection with «trade, business or profession» In this case the appellant has not lost his money as a result of the exercise of his profession

(3) Section 15 authorises the carrying forward and the setting off of a loss incurred in one year against the taxpayer s income for subsequent years until such loss is exhausted if it cannot be wholly set off against the person's income from other sources for that year of assessment It does not authorise any other deductions and it does not introduce any additional allowance other than trading losses

(4) As it clearly emerges from the authorities a professional man can maintain that a loss in respect of money lent is deductible in computing the profits of his profession only if there is an express finding to the effect that the loss was incurred in the course of carrying on his profession It seems that a similar finding is necessary in relation to any other kind of business in respect of which the lending of money is not generally accepted as being a part

(5) In the light of the above reasons this appeal has to be dismissed

B) Per Pikis, J (I) Mere recitation of section 13(d)* of the Income Tax Laws, invoked by counsel for the appellant in support of the proposition that the amount of £15,000 could be appropriately regarded as loss of trading stock,

---

* *Quoted at pp 611-612 post*

** *The relevant part is quoted at p 615 post*

shows the untenability of such argument

(2) The pertinent question upon which the outcome of this appeal rests is the relationship or nexus that must exist between the bad debts contemplated in s 11(1)(c) and the income from which it is sought to deduct them Like other deductible outgoings and expenditure the bad debts must have been incurred in the income earning process of the appellant They must arise in the course of the trade or business and be incidental thereto The section is not designed to afford relief from losses incurred from investments unless such investments are made in the course of an investment business Likewise a bad debt arising from a loan can only be deducted if money lending is the business wholly or partly of the taxpayer The object of s 11(1)(c) is to put bad debts in pari materia with outgoings and expenses wholly and exclusively incurred for the production of the income

(3) In the light of the aforesaid principles this appeal should be dismissed

Appeal dismissed
No order as to costs

Cases referred to

Allied Newspaper Ltd v Hindsley [1973] 4 All E R 677

Odhams Press Ltd v Cook [1940] 3 All E R 15

HadjiPavlou and Sons v The Republic (1967) 3 C L R 711

Reid s Brewery Company v Male 3 T C 279

Stott v Hoddinott 7 T C 85

Rutherford v I R Comrs 23 T C 8

Bury and Walkers v Philips 32 T C 198

Appeal.

Appeal against the judgment of Judge of the Supreme Court of Cyprus (Demetriades, J) given on the 18th October 1986 (Revisional Jurisdiction Case No 26/81)* whereby appellant's recourse against the decision of the respondents to treat the sum of £15,000 - lent by applicant to Thassos Motels Ltd as capital loss and to refuse its being set off against applicant's income for the year 1975-1977 was dismissed

L Papaphilippou, for the appellant

A Evangelou, Senior Counsel of the Republic, for the respondent

Cur adv vult

* *Reported in (1986) 3 C L R 1755*

A LOIZOU J The Court has unanimously concluded that this appeal should be dismissed

The reasons that led my learned Brethren Malachtos, Savvides Kourris and myself to this result are the following Justice Pikis will be delivering his own reasons

The appellant who comes from Famagusta was the Senior Officer in charge of the Famagusta Branch of Russel and Co , Chartered Accountants He left that service in 1973 and started on his own practicing his profession as accountant and auditor in that town At the same time he took up the management of the «Rebecca» Hotel in Famagusta which was the property of Thassos Motels Ltd The shareholders of this company are the appellant and his brother, each having £20,000 shares

As the company needed more money to run its hotel business, the appellant lent to it £50,000, the proceeds of the sale of a flat he owned His brother advanced another £35 000 The advance was to yield 8% interest As a result of the Turkish invasion and the occupation of Famagusta town by the Turkish troops on the 14th August 1974 the property owned by the said Company remained behind in Famagusta, whilst the appellant and his family moved to Nicosia, where since the 1st April 1975 is employed as accountant with Messrs Costas Sideris and Sons Ltd

The respondent Commissioner of Income-Tax raised assessments on the appellant for the years of income 1975 and 1976 to which the appellant objected claiming relief for losses suffered by him in Famagusta, one being the amount of £15,000 advanced to the company The respondent by his letter dated the 19th November 1980 rejected the claim of the appellant on the ground that the amount of £50,000 was a capital loss and not an expense wholly and exclusively incurred in the production of income That decision was challenged by the appellant by a recourse which was heard in the first instance by a Judge of this Court who dismissed same by his judgment in which he concluded as follows

> «To my mind, the amount lent by the applicant to the company was capital invested in another enterprise outside the usual course of the applicant's profession It was, therefore, not an exxpense wholly and exclusively incurred for the production of the income of the applicant in his profession and for this reason I dismiss the recourse »

As against that judgment the present appeal was filed, the

grounds of which are the following

«1 The Trial Judge wrongly did not decide the case within the ambit of section 15 of the Income-Tax Laws 1961 to 1979 and/or misinterpreted the provisions of the said section

2 The claim for allowing deductions for the amount of the loan was not made on the ground that the loss of this amount was a bad debt in relation to the exercise of his profession as an accountant nor that it was an expense for the production of profit (section 11) »

We have had the advantage of elaborate argument by learned counsel on both sides and we have come to the conclusion that on the authorities as they stand and which in a concise form are set out in Simon's Taxes 3rd Edition, Volume B p 630 paragraph B1 1305, the general principle is that «no sum can be deducted in respect of any loss which is not connected with or does not arise out of the trade A loss that is incurred in a transaction entered into for the purpose of earning the profits of the trade is a permissible deduction the question whether in any particular case the loss arose out of, or in connection with the trade is a question of fact »

In respect of this latter proposition the authorities given are *Allied Newspaper, Ltd. v Hindsley* [1973] 4 All E R 677 *Odhams Press Ltd v Cook* [1940] 3 All E R 15 23 T C 233 H L

Section 11 of the Income-Tax Laws 1961-1977 - and 23 confine the reference to these Laws as they were the ones applicable in the present case in so far as relevant reads as follows -

«11 -(1) For the purpose of ascertaining the chargeable income of any person there shall be deducted all outgoings and expenses wholly and exclusively incurred by such person in the production of the income including-

(c) bad debts incurred in any trade business, profession or vocation proved to the satisfaction of the Commissioner to have become bad debts during the year immediately preceding the year of assessment and actually written off during the same year notwithstanding that such bad debts were due and payable prior to the commencement of the said year, and also the amount of any specific provision for the doubtful debts in respect of which the Commissioner is satisfied that they have or will eventually become

irrecoverable

Provided that all sums recovered during the said year on account of amounts previously written off or allowed in respect of bad debts under the provisions of any previous law imposing tax on income or under the provisions of any law enacted by a Communal Chamber and imposing a personal tax in the form of income tax, or under the provisions of this Law shall, for the purposes of this Law be treated as receipts of the trade, business, profession or vocation for that year »

Section 13 on the other hand deals with deductions which cannot be allowed and by paragraph (e) thereof it prohibits such deductions in the cases of disbursements or expenses not being money wholly and exclusively laid out or expended for the purpose of acquiring the income And the same under paragraph (f) thereof regarding capital withdrawn or any sum employed or intended to be employed as capital

It has been argued by learned counsel for the appellant that the presence of the word «profession» (επαγγελμα) in section 11(1)(c) of the Law gives a different context to this provision as compared with the corresponding provisions of the English Laws We do not intend to enter into an analysis of the numerous provisions in the English Tax Legislation and the various rules applicable to the different Schedules in view of the clarity of the wording of own section

In our view the presence of this category in addition to the rest, included therein, does not give any assistance to the case of the appellant inasmuch as the «bad debt» eligible for deduction must have been incurred in respect of the profession of the taxpayer and not independently of it This is as in the case of a «bad debt» of a trader which must be connected with his trade In our case the loan which is sought to be deducted as a loss was not a debt incurred by the appellant in relation to his profession, the material words of the section being «incurred in any» which means in respect of or in connection with «trade, business, etc , or profession» with which latter category we are here concerned The appellant being an accountant and not a money lender and not having lost his money as a result of the exercise of his profession as an accountant

It was as such that the respondent Commissioner considered him and we find that that was reasonably open to him in determining that question of fact

As regards the second argument of learned counsel for the appellant in respect of section 15 this section authorises in our view the carrying forward and the setting off of a loss incurred in one year against the taxpayer's income for subsequent years until such loss is exhausted if it cannot be wholly set off against the person's income from other sources for that year of assessment It does not authorise any other deductions and it does not introduce any additional allowances other than trading losses Relevant in this respect is the case of *Hadjpavlou and Sons v The Republic* (1967) 3 C L R p 711 in which it was held that what was meant to be conveyed by the notion of losses in section 15(1) is a trading loss and not a capital one

The nature of the disputed payment in this case is that it was not connected with nor did it arise out of the trade carried out by the appellant who was at the time practising his profession of accountant and auditor The case of *Reid's Brewery Company v Male*, 3 T C 279 and the other cases given in *Simon's Taxes* (supra), bear out the proposition that no sum can be deducted in respect of any loss which is not connected with or does not arise out of the trading of the taxpayer and the trade would mean in this case, wholly or partly that of the lending of money

It is worth referring here indicatively to some of the relevant cases, bearing always in mind that the application of the principle depends on the particular facts of each case

In *Stott v Hoddinott*, 7 T C 85, an architect, in order to obtain business, took up shares in the companies granting the contracts, and subsequently sold the shares at a loss The sale of the shares was necessary in order to provide the respondent with funds for purchasing other shares with a view to obtaining other contracts It was held the loss in question was a loss of capital, and was, therefore not deductibe

In *Rutherford v. I R. Comrs*, 23 T C 8 a firm of Writers to the Signet also acted as factors, insurance agents and stockbrokers, and although they did not hold themselves out as financiers or moneylenders, they were in the habit of making advances to clients. These loans had always arisen directly out of their legal or other business The firm claimed to be entitled to deduct a sum representing the losses sustained in connection with loans made to two clients for the purchase of,

in the one case, farm stock, and, in the other, a farm. There was no proof that it was a custom of solicitors or Writers to the Signet generally to lend money to clients, but the firm contended that theirs was a composite business, including the lending of money, and that the sum in question was, therefore, a proper deduction. It was held that the losses were not connected with the firm's activities and were therefore not deductible.

In another case, *Bury and Walkers v. Philips*, 32 T.C. 198, no allowance was made for a loss on a loan to a builder by a firm of solicitors who had made a practice of advancing money for the purchases of land for housebuilding to builders who were usually, but not always, clients of the firm. No evidence was given of any practice among solicitors of making loans as a part of their business, and the firm were not successful in their contention that a separate trade of money lending was carried on and combined with their profession as solicitors.

It is reasonably clear from these cases that a professional man can maintain that a loss in respect of money lent is deductible in computing the profits of his profession only if there is an express finding to the effect that the loss was incurred in the course of carrying on his profession. A similar express finding would also be necessary, it seems, in relation to any other kind of business in respect of which the lending of money is not generally accepted as being a part.

For all the above reasons this appeal is, as we have already said, unanimously dismissed but in the circumstances there will be no order as to costs.

PIKIS J.: At the core of this appeal lies the interpretation of s.11(1)(c)* with a view to establishing the range of its application, particularly the nexus that must exist between bad debts and the income from which it is sought to deduct them. Applicant, a professional accountant in salaried employment, claimed a right to deduct from the computation of his chargeable income for the years 1975-1977, an amount of £15,000.- lent or used to buy shares in a family property company at Famagusta. The shareholders of the company were his brother and sister-in-law, himself being a minority

* *Income Tax Law*

shareholder The loan was made before 1974 at a time when the appellant resided in Famagusta and practised accountancy on his own

The Commissioner rejected the claim for a deduction on the ground that the loss did not represent anything in the nature of an expense incurred wholly and exclusively for the production of the income from which it was sought to deduct the debt The learned trial Judge upheld the decision and dismissed the recourse Also he doubted the irrecoverability of the debt considering that the town of Famagusta where the property is situate «is at present under Turkish occupation», adding this is a fact that would not at present «lead to the conclusion that the amount of £15.000 -lent by the applicant to the company will never be recovered » The learned trial Judge noted that the debt for which deduction was sought was not a trading debt and as such could not be deducted from the chargeable income of the appellant

Counsel for the appellant argued that the ambit of s 11(1)(c) is far wider than depicted by the trial Court and argued that its provisions cover bad debts incurred in any business context He drew attention to the fact that the loan made to the family company at Famagusta was not an isolate investment but part of a series of investments made by the appellant The other investments were shares in a coffee processing company and a deposit in a Bank Therefore, the income of the applicant did not derive solely from his professional earnings but from his investment business as well that he carried on side by side with his profession Also he invoked, with less enthusiasm it ..ıust be said, the provisions of s 13(d) in support of the claim for deduction, repeating the argument raised before the trial Court that the loss of the amount of £15,000 - could appropriately be regarded as loss of trading stock Mere recitation of the provisions of s 13(d) exposes the untenability of this argument It provides that deduction shall be allowed in respect of, inter alia, «the cost price of any goods taken out of the business for the use of the proprietor or any partner or the family of such proprietor or partner» No more need be said about the inapplicability of this provision of the law

The other ground upon which the decision was challenged was founded on the provisions of s 15 Counsel argued it is an omnibus provision permitting the deduction of losses however

incurred by the tax-peyer In reply counsel for the Republic submitted s 15 does not add to the list of allowable deductions for losses, but merely provides that losses otherwise deductible may be deducted not only from the chargeable income of the year in which they were incurred but may be carried forward and be deducted from the income of subsequent years until the loss is exhausted The decision in *Haggipavlu v Republic**, counsel added, settles that the ambit of s 15 is confined to trading losses I wholly agree that s 15 is a regulatory provision solely designed to lay down that trading losses may be carried forward until the loss is exhausted It does not in any way extend the range of deductible losses

We turn back to examine the applicability of the provisions of s 11(1)(c) to the facts of the case The answer of counsel of the Republic to the submissions of appellant is that the deductions allowed under this enactment are confined to trading debts The effect of this provision of the law is accurately summed up in *Simon's Taxes**** by reference to the provisions of corresponding English legislation It is depicted as follows «No sum can be deducted in respect of any loss which is not connected with or does not arise out of the trade» Further down it is noted that whether a particular loss arose out of or in connection with the trade is question of fact A deduction for lost loans, it is explained in *Simon's*, « can be obtained only if the trade is one consisting wholly or partly of the lending of money in that way If the loan was a transaction outside the scope of the trade on the other hand, and the loan is lost, no deduction in respect of it is admissible» These propositions are fully born out by the ratio of numerous decisions on the interpretation of corresponding English provisions*** In accordance with s 13(e), counsel reminded, only disbursements and expenses wholly and exclusively incurred for the purpose of acquiring the income are deductible

Mr Papaphilippou doubted the relevance of English case law as an aid to the interpretation of s 11(1)(c) for the reason that corresponding English statutory provisions do not refer to business losses as such, as a legitimate ground of deductibility

* *(1967) 3 C L R 711*

** *Vol 13 3rd ed pages 630 631 632*

*** *T A 1970 s 130(e) and s 519(1) and (2)*

The pertinent question upon which the outcome of this appeal rests is the relationship or nexus that must exist between the bad debts contemplated in s. 11(1)(c) and the income from which it is sought to deduct them. Like other deductible outgoings and expenditure, the bad debts must have been incurred in the income earning process of the appellant. They must, as accurately stated in *Simon's*, arise in the course of the trade or business and be incidental thereto. The section is not designed to afford relief from losses incurred from investments unless such investments are made in the course of an investment business. Likewise a bad debt arising from a loan can only be deducted if money lending is the business wholly or partly of the taxpayer. The object of s.11(1)(c) is to put bad debts in pari materia with outgoings and expenses wholly and exclusively incurred for the production of the income. This has only to be stated to demonstrate how untenable the claim of the appellant for deduction is. The loan was not made and had no connection or bearing with the income of the applicant from which it was sought to be deducted. The appeal must, therefore, fail. This being the case it is unnecessary to examine whether the loan of £15,000.- can be regarded as permanently lost.

In the result the appeal is dismissed.

Appeal dismissed.
No order as to costs.