

1988 December 31

[A. LOIZOU, P.]

IN THE MATTER OF ARTICLE 146 OF THE CONSTITUTION

ATHENAIKON STYL TSINGIS LTD.,

Applicants.

v.

THE REPUBLIC OF CYPRUS, THROUGH
THE COMMISSIONER OF INCOME TAX,

Respondent.

(Case No. 367/86).

5 *Taxation—Income Tax—The Income Tax Laws, sections 11(1) and 13(e)—
Expenses wholly and exclusively incurred for the production of income—
Companies limited by shares, incorporated under the Companies Law,
Cap. 113—Loans to Directors—Contrary to section 182 (1)—Therefore,
interest paid by company in respect thereof is not deductible.*

*Recourse for annulment—Practice—Statements of counsel as to facts—Can be
relied upon, if they are born out by the administrative files or if they are not
denied.*

10 *Legitimate interest—Acceptance of facts—No legitimate interest to challenge
them.*

The facts of this case sufficiently appear in the Judgment of the Court.

Recourse dismissed.

No order as to costs.

Cases referred to:

Vita Ora Co. Ltd. v. The Republic (1973) 3 C.L.R. 273;

Georghiou v. The Republic (1986) 3 C.L.R. 1755.

Recourse.

Recourse against the income tax assessment and the special contribution imposed on applicants for the years 1973-1983. 5

M. Pelides, for the applicants.

A. Evangelou, Senior Counsel of the Republic, for the respondents.

Cur. adv. vult. 10

A. LOIZOU P. read the following judgment. By the present recourse the applicant Company seeks:

"A. A Declaration that the Respondent's act of investigating the Applicants' income tax liability for the years of assessment 1973-1979 and the Applicants' liability for special contribution levy for the years of assessment prior to 1980 is null and void and of no legal effect whatsoever. 15

B. A Declaration that the Assessment of the Applicants' income for the years of assessment 1973-1983 and the imposition of tax thereon is excessive and/or null and void and of no legal effect whatsoever. 20

C. A Declaration that the Respondent's assessment of Applicants' income for special contribution for the quarters 2/82 to 4/82 and 1/83 to 4/83 and the imposition of interest thereon is null and void and of no legal effect whatsoever." 25

The applicant Company is a private company with limited lia-

bility incorporated on the 22nd June 1973. Its authorised share capital on the 31st December 1983 was 160,000 Ordinary Shares of one pound each and its issued and fully paid share capital was 50,000 shares of one pound each. It derived its income, during the material time from the manufacture and sale of shoes.

The accounts for the period 1st July 1973 to 31st December 1984 and for the years 1975 to 1983 which were submitted on various dates by the auditors of the applicant Company, were examined and the computations of chargeable income were adjusted as shown on the statement attached to the letter of the respondent Commissioner of the 23rd January 1986, addressed to the company's auditors Messrs Ioannou, Zampelas and Co. Notices of assessment were also sent on the 24th January 1986, to the applicant Company for the year of assessment 1977 (year of income 1976) which was under objection and for the years of assessment 1981, 1982 and 1983 (Appendix "C").

By their letter of the 11th February 1986 the auditors of the applicant Company objected against the 1981, 1982 and 1983 income tax assessments and against the special contribution assessments for the quarters February 1982, to April, 1983, on the ground that they disagreed with the decision of the respondent Commissioner to disallow part of the Bank interest charged in the profit and loss accounts as the company had substantial profits for the years 1978 and 1980 to 1983 and consequently the financing of the directors current accounts was effected out of the company's profits and not out of the overdraft or loan accounts (Appendix "D").

The respondent Commissioner having considered the objection filed on behalf of the applicant Company maintained his original decision to disallow the said amounts of interest as shown on the statement attached to his letter of the 23rd January 1986 and determined the objection accordingly and informed the applicant Company of his decision, (Appendix "E") by letter dated the 26th March, 1986 together with the notices of tax payable dated the 26th March, 1986.

By their letter of the 18th April 1986, the applicant Company's auditors gave supplementary information to the respondent Commissioner regarding his arguments that the company had profits and that the financing of the directors' current accounts was effected out of the Company's profits and not out of the overdraft and loan accounts. (Appendix "F"). 5

After considering the auditor's said letter, the respondent Commissioner maintained his original decision and informed the applicant Company by his letter of the 9th May 1986, (Appendix "G") that he has nothing to add to his letter of the 26th March, 1986. 10

By their present recourse to the Court, the applicant Company introduced additional points of objection on matters that had previously been, as claimed by the respondent Commissioner agreed between him and the applicant's auditors and that in fact the applicant Company disputes the respondent Commissioner's decision to disallow various items of expenditure as indicated in the latter's letter of the 23rd January 1986. 15

In paragraph 12 of the opposition the points in dispute in the present recourse as disallowed by the respondent Commissioner are summed up as follows:- 20

"(a) Capital allowances on furniture - 1981

The company in its accounts claimed accelerated depreciation in respect of furniture, amounting to £1,310. This was disallowed and a writing down allowance (WDA) of 10% allowed instead. 25

i.e $(£1310 - £131) = £1,179$. The 10% W.D.A. of £131 was also allowed in 1981 and 1982.

The company was not eligible to accelerated depreciation, on furniture in 1981 under s.12 of the Income Tax Laws 1961-1981. 30

(b) Customers entertainment expenses

1976 1977 1978 1979 1980 1981 1982 1983

Per accounts £1719 £1673 £ 2643 £1647 £1938 £1825 £2013 £3611

5 Amount
disallowed £500 £500 £500 £500 £500 £500 £500 £500

(c) Overseas travelling expenses

10 Per accounts 1978 1979 1980 1981 1982 1983
£1728 £ 243 £ 2369 £3529 £4371 £6991

Amount
disallowed £500 — £500 £500 £500 £500

15 Regarding points (b) and (c) above the amount of £500 disallowed in the years indicated, had been agreed between the respondent and the applicant company's auditors.

(d) Valuation of building expenses — £300 in 1979.

(e) Mortgage expenses — £1138 in 1981

20 The Respondent Commissioner disallowed both the above mentioned expenses claimed by the Applicant company as a deduction in its accounts in 1979 and 1981 on the grounds that these expenses were not expenses wholly and exclusively incurred in the production of income. This had been

25

(f) Investment allowances.

The investment allowance for scissors and other items was disallowed in 1975 and 1976 in view of the fact that the Applicant Company had opted for the renewals basis in respect of such articles. Therefore the provisions of s. 12 of the Income Tax Laws 1961 to 1983 regarding plant and machinery would not be applied. Under the renewals basis which is applied by concession, the system of capital allowances is not applied but when a piece of machinery or plant comes to be renewed the net cost of replacement (i.e. the cost of the new item less anything received for the old), excluding amounts representing additions or improvements is allowed as a deduction. However this basis is applied as an alternative to the provisions of section 12 of the Income Tax Laws and no investment allowances are granted where this basis is applied.

5

10

15

(g) Salaries of Mrs. Panayiota Tsingi.

	1979	1980	1981	1982	1983
Per accounts	£1000	£2000	£2000	£3000	£3500
Amounts disallowed	—	500	500	1200	1500

20

On the basis of available evidence Mrs Tsingi does not appear to work regularly for the applicant company. Therefore part of her salary was disallowed as not being an expense wholly and exclusively incurred in the production of income.

25

This had been agreed with the applicant Company's auditors.

(h) Interest not allowed

	1978	1979	1980	1981	1982	1983
Disallowed	£112	£630	£1476	£2270	£2673	£2780

30

5 The above amounts of interest claimed by the applicant Company were disallowed by the Respondent since they were not an expense incurred wholly and exclusively for the production of income but for the purpose of financing advances by the company to its directors.

The amounts disallowed for each were arrived at by applying 9% to the average of the directors loan accounts at the beginning and end of the year.

10 This was the only point which had not been agreed between Applicant company's auditors and Respondent"

15 It is the case for the applicant Company that there was never any agreement between them through their auditors and the respondent Commissioner. Their version is that, following their objections, there were several meetings between their auditors and officers of the respondent Commissioner and in the course of these negotiations an understanding reached in the form of a package deal. This understanding was however, rejected by the respondent Commissioner and therefore it never crystalized into an agreement.

20 Before proceeding any further I would like to resolve this issue which has not been carried any further than the statements of counsel on both sides, though four weeks time was allowed by the Court to the applicant Company to file any affidavit and the same period to the respondent Commissioner, as well for filling
25 an affidavit in reply.

It has been the practice of this Court to accept statements of counsel as forming part of the factual substratum of the case so long as same was born out from the material in the file or was not questioned by the other side.

30 In the present case there is an assertion on behalf of the applicant Company, which is questioned by the respondent Commis-

sioner, to proceed further and invoke the letter of the auditors of the applicant Company of the 11th November 1986, by which they submitted objections to the alterations effected to the taxable income of their client contained in the letter of the 23rd January 1986, as well as to the tax assessed and the only ground was that the respondent Commissioner did not accept the interest which related to the directors of the Company, (Appendix "D"). It is contended on this ground by the respondent Commissioner that by merely confining their objection to the question of interest the applicant Company had accepted the agreement reached and so it did not object to the other amendments effected by the respondent Commissioner.

Moreover the auditors of the applicant Company after the final decision of the respondent Commissioner was communicated to them asked by their letter dated the 18th April 1986, from him to re-examine the case in so far as it referred to the interest which was not allowed by him. That was the only point which they were seeking for re-examination (Appendix F). On the 9th May 1986, the respondent Commissioner informed the applicant Company that he had nothing to add to his final decision which had been taken on the 28th March, 1986, (Appendix G). That being so I have come to the conclusion that the sole issue before me for determination is that of the interest, the rest having been accepted by the applicant Company, and so they are left with no legitimate interest to proceed with the rest of the issues raised by the present recourse which should fail to that extent.

I consider it, however, useful to examine all the grounds of law so that in case I am found to have erred on this issue the whole case can be reviewed on appeal.

I start with the interest which was not allowed by the respondent Commissioner. In respect of this point the argument is that the respondent Commissioner failed to ascertain the correct factual background and therefore he was at all material times labouring under a misconception of fact. It was further submitted on behalf of the applicant Company that the sub judice decision was not

reasonably open to the respondent Commissioner on the material before him. In particular by a letter dated the 18th April 1986, (Appendix "F"), the applicant Company claimed that the deduction should be allowed for the following grounds:-

5 (i) as it appears from page 3 of Appendix "F" the applicant Company had made profits in all the years from 1980-1983.

(ii) This profit in each year was much higher than either the increase in the company's overdraft or the increase in the directors' current accounts.

10 (iii) The Company also had substantial writing off allowances.

(iv) Accordingly no one can argue that the increase in the directors current accounts was paid from the overdraft and not from the Company's profits, or from the writing off allowances, which is the applicants' allegation.

15 As stated above the decision of the respondent Commissioner is wrong on a least two grounds, namely:-

(a) that he failed to make a correct assessment of the factual background and his conclusions were therefore wrong; and

20 (b) that on the facts before him the decision was not reasonably open to him.

The answer to the aforesaid contentions is that the applicant Company is an enterprise exclusively engaged in the manufacture and sale of shoes and not in the lending of money and therefore
25 the lending of money to its directors is contrary to law and in particular to Section 182(1) of the Companies Law, Cap. 113. On this basis the interest derived from the lending of money to its Directors does not constitute expenses wholly and exclusively incurred for earning an income as provided by Sections 11(1), 13
30 (e) of the Income-Tax Laws. Such an issue was judicially consid-

ered in the case of *Vita Ora Co. Ltd. v. The Republic* (1973) 3 C.L.R. 273, where it was held that since an amount given to the directors of that Company in the form of a loan was not used for the purposes of the Company as required by Section 34, subsection (2) of the Income-Tax Law as amended by Section 31 of the Income-Tax (Amendment) Law 1969 (Law No. 60 of 1969), the applicant Company in that case was not taxed with reduced factors.

5

Moreover in the case of *Stavros Georghiou v. The Republic* (1986) 3 C.L.R. 1755, approved on appeal, the Court held that in order that the taxpayer, may be entitled to a reduction provided by section 11(1) (e) of the Income-Tax Laws 1961-1977, he had to satisfy the respondent Commissioner that the amount for which he is claiming a deduction must constitute expenses wholly and exclusively incurred for the earning of an income.

10

15

In view of this and as the matter turned on the factual background of the case, this ground should fail.

In the result the recourse is dismissed, the sub judge decision confirmed, but in the circumstances, however, there will be no order as to costs.

20

Recourse dismissed.
No order as costs.