IN THE MATTER OF ARTICLE 146 OF THE CONSTITUTION

YIANNAKIS S. DROUSSIOTIS

Applicant,

and

THE REPUBLIC OF CYPRUS, THROUGH
THE MINISTER OF FINANCE, AND ANOTHER

Respondents.

(*Case No.* 255/65).

Income Tax—Assessments—Income subject to tax—Sale of immovable property—Gain derived from—Whether or not such gain amounts to taxable income or constitutes a mere accretion of capital—Material dates to be considered—Right approach to the aforesaid issues—Factors to be considered—Apart from the general principles applicable to the matter, it is legitimate in Cyprus to take into account the part that real estate plays in the economic life of the country—Where there is no stock exchange and the main and almost sole field for investment is immovable property—The right test to be applied—The intention of the taxpayer is not the determining factor—But one of the many relevant factors to be considered in deciding whether the surplus derived from sale of immovable is income subject to tax or mere capital accretion.

Income Tax — Assessments — Determination of objections against assessments—Need to be duly reasoned—Irrespective of what may have been the practice before the coming into operation of Article 146 *of the Constitution, there is no doubt that when nowadays an objection against an assessment is being determined it is necessary to reason duly the relevant decision.*

Administrative Law—Administrative decisions—Need to be duly reasoned—Article 146 *of the Constitution—See, also, under Income Tax immediately above.*

Immovable Property—Sale of—Surplus realised—When subject to income tax—See under Income Tax above.

Sale of immovable property—Surplus—Income Tax—See above.

By this recourse under Article 146 of the Constitution the Applicant challenges the validity of the decisions of Respondent 2, determining his objections against two income tax assessments in respect of the years of assessment 1959 and 1961, respectively. Applicant complains that such assessments erroneously treat as part of his relevant taxable income amounts representing the difference between the prices at which the Applicant sold in 1958 and 1960, respectively, two building sites, and the cost to him of such building sites, when purchased by him, as part of an undivided area of land, in 1941 The history of the events is shortly as follows:

In 1941 the Applicant purchased an area of land situated at Ayia Phyla, near Limassol; the extent of this area was about 10 donums, and he paid for it £500. At the time it was agricultural land, and it was so until about 1956. This is the only area of land, of this nature, which has been purchased by Applicant. In 1956 the Applicant constructed roads and divided the said area into 21 building sites. Over the years, the Applicant has sold a number of these sites, using the proceeds to repay liabilities contracted through the erection of his new business premises in Limassol; in particular in 1959 he sold a site for £1,000, and in 1960 another site for £900.

By the *sub judice* decision there have been treated as part of Applicant's income, an amout of £950 in respect of the year of assessment 1959, and an amount of £850 in respect of the year of assessment 1961, representing the difference between the sale price of the two aforesaid building sites and their initial cost to Applicant.

No reasons were ever given why the surplus derived by Applicant from the sale of the sites in question has been treated by the Respondents as taxable income.

During the hearing of the case counsel for the Respondents has stated to the Court that the *sub judice* decisions are, in any event, erroneous to a certain extent and will have to be revised, because they were based on the cost of the sites to the Applicant in 1941, whereas they ought to have been based on the cost of the sites in 1954, when the Applicant applied for the relevant

permit to divide the land in question into building sites. The Court thought that the above view was very properly and fairly taken by counsel on behalf of the Respondents, and that it was, also, correct in principle, assuming the profit made by Applicant on the sale of the said two sites is taxable at all. The Court, therefore, held that it was a misconception, vitiating the validity of the decisions complained of, to rely on the cost in 1941 of the sites, instead of on the 1954 cost thereof. Consequently, the Court held that the *sub judice* said decisions have to be declared null and void and of no effect whatsoever, and that the relevant objections of the Applicant to the aforesaid two assessments in respect of the years of assessment 1959 and 1961, respectively, have to be considered and determined afresh, in the light of certain basic principles laid down in the course of the judgment in the present case.

The Court in granting the application and annulling the decisions complained of:

Held, (1) (*a*) I think that it was a misconception, vitiating the validity of the relevant decisions, to rely on the 1941 cost of the sites, instead of on the 1954 cost thereof.

(*b*) It follows that the *sub judice* decisions have to be declared null and void, and that the objections of the Applicant to the assessments in respect of the years of 1959 and 1961, respectively, have to be considered and determined afresh; in the light of certain principles outlined in this judgment, as well as of any other relevant principle or consideration.

(2) (*a*) An issue such as the one in question in this case, *viz.* whether or not the surplus from the sale of the two aforesaid sites must be treated as taxable income of the Applicant, is essentially an issue of mixed law and fact, which has to be decided in the light of the particular circumstances of each case (see: *Savvas M. Agrotis Ltd.* v. *The Commissioner of Income Tax* 22 C.L.R. 27, at p. 30 and the relevant jurisprudence in England such as *Jones* v. *Leeming* 99 L.J. K.B. 318, at p. 321 per Lord Dunedin: "There is no new question of law involved in it, merely the application of old principles to the particular facts".

(*b*) Also in approaching such an issue in Cyprus, it must be borne in mind that, the following, which has been stated in *Agrotis* case (*supra*, at p. 33) by Hallinan C.J. in 1956, appears to still hold good, ten years later, today:

"I think it is admissible for the Court below and for us on appeal to take into account the part that real estate plays in the economic life of Cyprus. Here, the main and almost sole field for investment is immovable property. There is no stock exchange........ Most Cypriot individuals and families of substance put their money into land as an investment......"

(3) The test to be used in resolving an issue such as the one with which we are concerned has been laid down in the case of *Californian Copper Syndicate* (*Limited and Reduced*) v. *Harris*, 5 Tax Cases 159 at pp. 165–166: ".......each case must be considered according to its facts; the question to be determined being—Is the sum of gain that has been made a mere enhancement of value by realising a security, or is it a gain made in an operation of business in carrying out a scheme for profit making? " This test has been adopted in the *Agrotis* case (*supra*, at p. 29) and also in a very recent English case, on the same point, *Pilkington* v. *Randall* (Ann. Tax Cases XLV (1966) 32, at p. 35).

(4) It is quite correct that the nature of a transaction must be examined objectively and that "the intention of a man cannot be considered as determining what it is that his act amounts to". (see: *O'Kane and Co.* v. *The Commissioners of Inland Revenue*, 12 Tax Cases 303, at p. 347, per Lord Buckmaster). But, on the other hand, it may well be that the intention, at the material time, of the taxpayer concerned constitutes one of the relevant factors which have to be weighed in arriving safely at the correct evaluation of the position. This, I think, is to be derived clearly from the *Pilkington* case (*supra*).

(5) It is to be borne in mind, further, that the fact that an investment has been made with a view to its increasing in value and being realised at a profit is not by itself a taxable income (see: *Jones* case, *supra*, at p. 321 per Lord Buckmaster; and at pp. 323–324 per Lord Warrington).

(6) (*a*) When on the other hand the profit is realised in the course of ordinary trading the matter is entirely different and the resulting income is taxable. Such was the position in the case *The Commissioners of Inland Revenue* v. *Livingston and Others*, 11 Tax Cases 538, at pp. 542–543 per Lord Clyde.

(*b*) It is not, however, inevitable to conclude, always, when there has taken place sale of land, or of other capital, after

development, that the resulting profit is taxable income and not merely a capital accretion not subject to income tax. In this respect it is useful to bear in mind the dictum of Rowlatt J. in *Rand* v. *The Alberni Land Company Ltd.*, 7 Tax Cases 629 at pp. 638–639, which dictum has to be read in the light of the observation of Salmon L.J. in the *Pilkington* case, (*supra*, at p. 35).

(7) Lastly, the mere fact that the proceeds of the realisation of immovable property, which has increased in value, have been used for the acquisition of other income producing property, does not seem to be a factor of a decisive nature, if otherwise a conclusion against the taxpayer is not warranted by the whole circumstances of the particular case. This is to be derived from *Agrotis* case (*supra*, at p. 35) and from the *Limassol Land Investments Ltd.* v. *The Commissioner of Income Tax* 22 C.L.R. 27.

Decision complained of declared null and void. Applicant entitled to part of his costs assessed at £18.

Per curiam: Irrespective of what may have been the practice before the coming into operation of Article 146 of the Constitution, there is no doubt that when nowadays an objection against an assessment is being determined it is necessary to reason duly the relevant decision: And if this cannot be done in the formal notice of determination of the objection, then the reasons therefor must be recorded in and, also, made known to the objector by, an appropriate communication.

Cases referred to:

Savvas Agrotis Ltd. v. *The Commissioner of Income Tax* 22 C.L.R. 27, at pp. 29, 30, 33 and 35, *followed;*

Jones v. *Leeming* 99 L.J. K.B. 318, at p. 321 per Lord Dunedin, *followed; ibid.* per Lord Buckmaster, *followed;* and at pp. 323–324, per Lord Warrington, *followed;*

The Californian Copper Syndicate (*Limited and Reduced*) v. *Harris*, 5 Tax Cases 159, at pp. 165–166, *followed;*

O'Kane and Co. v. *The Commissioners of Inland Revenue*, 12 Tax Cases 303 at p. 347 per Lord Buckmaster, *followed;*

Pilkington v. *Randall*, Ann. Tax Cases XLV (1966) 32, at p. 35, per Salmon L.J., *followed;*

The Commissioners of Inland Revenue v. *Livingston and Others*, 11 Tax Cases 538, at pp. 542–543, per Lord President Clyde, *followed;*

Rand v. *The Alberni Land Company Ltd.*, 7 Tax Cases 629, at pp. 638–639, per Rowlatt, J., *followed;*

The Limassol Land Investments Ltd. v. *The Commissioner of Income Tax* 22 C.L.R. 27, *followed.*

Recourse.

Recourse against the validity of the decisions of Respondent 2, determining Applicant's objections against two income tax assessments in respect of the years of assessment 1959 and 1961.

A. Myrianthis for the Applicant.

M. Spanos, Counsel of the Republic, and Chr. Paschalides for the Respondent.

Cur. adv. vult.

The following Judgment was delivered by:

TRIANTAFYLLIDES, J.: By this recourse the Applicant challenges the validity of the decisions of Respondent 2, the Commissioner of Income Tax (now Director of Inland Revenue), determining his objections against two income tax assessments (399/AD/60 and 853/AD/63 (61)) in respect of the years of assessment 1959 and 1961; Applicant complains that such assessments erroneously treat as part of his relevant taxable income amounts representing the difference between the prices, at which Applicant sold in 1958 and 1960, respectively, two building sites, and the cost to him of such building sites, when purchased by him, as part of an undivided area of land, in 1941.

The relevant notices of determination of the objections of the Applicant are *exhibit* 1 *and* 2, respectively, in these proceedings, and they are both dated 16th October, 1965.

Exhibit 1 is based on the provisions of the Taxes (Quantifying and Recovery) Law 1963 (Law 53/63) – as well as on the relevant

provisions of the Income Tax Law, Cap. 323; *exhibit* 2 is based on the provisions of the Imposition of Personal Contributions on Members of the Greek Community for the Year 1961, Law (Greek Communal Chamber Law 16/61); the relevant provisions of the aforesaid enactments are to all intents and purposes the same as far as the issues arising in this recourse are concerned.

Counsel for Respondents has stated to the Court that the history of relevant events, as given by counsel for Applicant in his opening address, is substantially correct; such history is as follows:

In 1941 the Applicant purchased an area of land situated at Ayia Phyla, near Limassol; the extent of this area was about 10 donums, and he paid for it £500. At the time it was agricultural land, and it was so used until about 1956. The Limassol by-pass, joining the road to Nicosia and Paphos, did not exist in 1941, and the road leading from Limassol to Ayia Phyla was not asphalted. There was no electricity or water-supply there, and there were no houses built there, either.

This is the only area of land, of this nature, which has been purchased by Applicant till this day.

In 1956 the Applicant constructed roads and divided the said area into 21 sites.

In 1957 he sold the first site, and he used the proceeds towards the cost of purchasing an old building in Limassol, which he intended to demolish, in order to build at its site his new business premises. As a matter of fact he did so in 1962.

Over the years Applicant has sold a number of sites, using the proceeds to repay liabilities contracted through the erection of his new business premises; in particular in 1958 he sold a site for £1,000, and in 1960 another site for £900.

By the *sub judice* decisions there have been treated, as part of Applicant's income, an amount of £950, in respect of the year of assessment 1959, and an amount of £850, in respect of the year of assessment 1960, representing the difference between the sale prices of the two aforesaid building sites and their initial cost to Applicant.

When the Applicant received the original assessments, for the years of assessment concerned, he objected in writing on the

21st June, 1960 and 12th July, 1963, respectively (see *exhibit* 3 *and* 4). Applicant's objection against the assessment for 1959 is fully reasoned; his complaint against the aforementioned amount of £950 being treated as income is clearly and explicitly taken. The objection against the assessment for 1961 is in general terms, but it relies on accounts already submitted to the income tax authorities; again, one of the matters in dispute was the treatment of the aforementioned amount of £850 as income relevant to the year of assessment 1961. As already, stated, the said objections of Applicant were determined by the *sub judice* decisions and it is common ground that they were rejected in so far as the amounts of £950 and £850 were concerned *i.e.* such amounts continued to be treated as being taxable income of the Applicant in relation to the two respective years of assessment.

During the hearing of this Case counsel for Respondents has stated to the Court that the *sub judice* decisions are, in any case, erroneous to a certain extent and will have to be revised, because they were based on the cost of the sites to the Applicant in 1941, whereas they ought to have been based on the cost of the sites in 1954, when Applicant applied for a permit to divide the land in question into building sites.

I think that the above view was very properly and fairly taken by counsel for Respondents, and that it is, also, correct in principle – assuming the profit made by Applicant on the sale of the sites is taxable at all. It was, therefore, a misconception, vitiating the validity of the relevant decisions, to rely on the 1941 cost of the sites, instead of on the 1954 cost thereof. It follows, that such decisions have to be declared to be null and void and of no effect whatsoever, and that the objections of the Applicant to the assessments in respect of the years of assessment 1959 and 1961 have to be considered and determined afresh.

The annulment of the said two decisions, as made, renders it, indeed, unnecessary to decide their validity on the wider issue of whether or not the surplus derived by Applicant from the sale of the sites in question amounts to taxable income. Moreover, I am not in a position to decide safely such an issue, on the merits of the present Case, because of the fact that apart from *exhibits* 1 *and* 2, which are not duly reasoned on this point, no other decision or record has been produced setting out the reasons for which the said surplus has been treated as

taxable income. Councel for Respondents has put forward certain arguments in support of such a course, but, even if they are to be regarded as being considerations leading to the decisions complained of, they cannot be treated as the due reasoning that one would have expected to have come into existence contemporaneously with the said decisions.

Irrespective of what may have been the practice before the coming into operation of Article 146 of the Constitution, there is no doubt that when nowadays an objection against an assessment is being determined it is necessary to reason duly the relevant decision; and if this cannot be done in the formal notice of determination of objection, then the reasons therefor must be recorded in, and, also, made known to the objector by, an appropriate communication.

As indicated already, I ought not, in the circumstances, to decide directly the issue of whether or not the surplus from the sale of the sites has been properly treated as taxable income of the Applicant; but having heard legal argument thereon, I might, for the guidance of the parties – and particularly of the income tax authorities in approaching such issue again– refer to what appear to me to be some relevant principles:

There is no doubt that, an issue, such as the one in question, is essentially an issue of mixed law and fact, which has to be decided in the light of the particular circumstances of each case; this has been recognized in *Savvas M. Agrotis Ltd.* v. *The Commissioner of Income Tax*, (22 C.L.R. p. 27 at p. 30) and in relevant jurisprudence in England, such as *Jones* v. *Leeming* (99 L.J. K.B. p. 318 at p. 321) where, with regard to a similar issue, Viscount Dunedin has stated: "There is no new question of law involved in it, merely the application of old principles to the particular facts".

Also, in approaching such an issue in Cyprus, it must be borne in mind that, the following, which has been stated in the *Agrotis* case (*supra*, at p. 33) by Hallinan C.J. in 1956, appears to still hold good, ten years later, to day:

"I think it is admissible for the Court below and for us on appeal to take into account the part that real estate plays in the economic life of Cyprus. Here, the main and almost sole field for investment is immovable property. There is no

stock exchange.........Most Cypriot individuals and families of substance put their money into land as an investment....".

The test to be used in resolving an issue such as the one with which we are concerned, has been laid down in the case of *Californian Copper Syndicate (Limited and Reduced)* v. *Harris* (5 Tax Cases p. 159 at p. 165–166). In this connection, Lord Justice Clerk had this to say, *inter alia*:

"....each case must be considered according to its facts; the question to be determined being – Is the sum of gain that has been made a mere enhancement of value by realising a security, or is it a gain made in an operation of business in carrying out a scheme for profit making?".

This test was adopted in the *Agrotis* case (*supra*, at p. 29) and also in a very recent English case, on the same point, *Pilkington* v. *Randall* (Ann. Tax Cases XLV (1966) p. 32 at p. 35).

It is quite correct that the nature of a transaction must be examined objectively and that, as Lord Buckmaster has said in a taxation case, *O'Kane & Co.* v. *The Commissioners of Inland Revenue* (12 Tax Cases p. 303 at p. 347) "...the intention of a man cannot be considered as determining what it is that his acts amount to". But, on the other hand, it may well be that the intention, at the material time, of the taxpayer concerned constitutes one of the relevant factors which have to be weighed in arriving safely at the correct evaluation of the position. This, I think, is to be derived clearly from the *Pilkington* case (*supra*). The facts of the said case were as follows:

"The appellant and another were the executors of the appellant's father's will, and held the residuary estate which comprised some land on trust for sale. The income of the residuary estate was to be paid to the widow for life, and then, in the event of his two children, the appellant and his sister, surviving him, to them in equal shares. The widow died in 1945 survived by the appellant and his sister.

Between 1929, when the father died, and 1939 the executors made several roads on the land forming part of the residuary estate, and they sold about thirty acres in plots, so that in 1939 there were about seventy acres

left. Some of the plots were let on long leases, and after the war the executors distributed the freehold reversions of these plots. In 1947 the other executor died, and from then onwards the appellant, as sole executor, held the estate on trust to sell it and divide the proceeds between himself and his sister. From 1949 to 1953 the appellant as executor sold more of the land, and in the latter year there were about forty-five acres left.

In 1953 a difference of opinion arose between the taxpayer and his sister as to the disposal of those forty-five acres. The sister wanted all the land sold as soon as possible, so that she could have her half-share of the purchase price; while the appellant wanted to spend money by building roads and sewers and then to dispose of the forty-five acres gradually. In 1954 the appellant bought out his sister's interest in a ten-acre plot for £4,000, and in the following year he bought out her share in the remaining thirty-five acres for £16,400. Subsequently the taxpayer constructed a service road, and had drains and services installed so as to sell plots to the best advantage. The sales were made through an estate agent.

Assessments were made on the appellant for 1953–54 to 1962–63 in sums totalling £55,000 in respect of profits arising from the development and sale of land.

It was contended on behalf of the appellant that the development of land by an executor or trustee with a view to its sale did not constitute a trade and that the purchase by one beneficiary of another beneficiary's interest in the proceeds of sale could not be regarded as involving the commencement of a trade. It was contended on behalf of the Revenue that the appellant had started to trade as an estate developer in 1954, when he purchased his sister's interest, and that that trade included all subsequent purchases and sales of land. The Special Commissioners decided in favour of the Revenue".

It was held on appeal, affirming the Judgment of Cross, J., (Ann. Tax Cases XLIV (1965) p. 228) that "there was no ground for disturbing the Special Commissioners' decision".

As it appears from the Judgment of Lord Justice Salmon, the intention of the appellant taxpayer was one of the material

considerations in this case. Salmon L.J. had this to say on the point (at p. 35):

> "I think one of the circumstances which is in favour of the Special Commissioners' view is that the appellant, when he bought out his sister's share, did so, as the Special Commissioners have found, with the intention of making a profit out of the whole of the land by reselling it after development. Although the intention with which the land was acquired is by no means an absolute criterion, if is a factor, when there is doubt, which can be thrown into the balance, as is laid down by Lord Reid in *Iswera* v. *Ceylon Commissioner of Inland Revenue*" ([1965] 1 W.L.R. p. 662).

It is to be borne in mind, further, that the fact that an investment has been made with a view to its increasing in value and being realised at a profit is not by itself sufficient to render the said profit a taxable income. As put by Lord Buckmaster, in the *Jones* case (*supra*, at p. 321): "...an accretion to capital does not become income merely because the original capital was invested in the hope and expectation that it would rise in value; if it does so rise, its realisation does not make it income". Also Lord Warrington said in the same case (at p. 323–324): "Here we have a case of the acquisition of an item of property and a profit made by the transfer thereof to another. In this I can find nothing but a profit arising from an accretion in value of the item of property in question and the realisation of such enhanced value. There is in this nothing in the nature of revenue or income. The fact that the parties intended from the first to make a profit if they could does not in my opinion affect the question we have to determine".

In that case the taxpayer and others had bought land in the Malay Peninsula and sold it for a profit, the taxpayer's share being £600, upon which he was assessed to income tax. The Income Tax Commissioners having found as a fact that the transaction was not a concern in the nature of trade it was held on appeal, by the Court of Appeal, and affirmed by the House of Lords, in England, that the said £600 was not taxable income.

When on the other hand the profit is realised in the course of ordinary trading the matter is entirely different and the resulting income is taxable. Such was the position in *The*

Commissioners of Inland Revenue v. *Livingston and others* (11 Tax Cases p. 538) where Lord President Clyde had this to say (at p. 542–543):.

"I think the test, which must be used to determine whether a venture such as we are now considering is, or is not, 'in the nature of trade', is whether the operations involved in it are of the same kind, and carried on in the same way, as those which are characteristic of ordinary trading in the line of business in which the venture was made. If they are, I do not see why the venture should not be regarded as 'in the nature of trade', merely because it was a single venture which took only three months to complete. The Respondents began by getting together a capital stock sufficient (1) to buy a second-hand vessel, and (2) to convert her into a marketable drifter. They bought the vessel and caused it to be converted at their expense with that object in view, and they successfully put her on the market. From beginning to end, these operations seem to me to be the same as those which characterise the trade of converting and refitting second-hand articles for sale..... The profit made by the venture arose, not from the mere appreciation of the capital value of an isolated purchase for resale, but from the expenditure on the subject purchased of money laid out upon it for the purpose of making it marketable at a profit. That seems to me of the very essence of trade".

It is not, however, inevitable to conclude, always, when there has taken place sale of land, or of other capital, after development, that the resulting profit is taxable income and not merely a capital accretion not subject to income tax. In this respect it is useful to bear in mind the dictum of Rowlatt, J., in *Rand* v. *The Alberni Land Company Ltd.* (7 Tax Cases p. 629 at p. 638–639):

"If a land-owner, finding his property appreciating in value, sells part of it, and uses part of his money still further to develop the remaining parts, and so on, he is not carrying on a trade or business; he is only properly developing and realising his land".

This dictum must be read in the light of the following observations of Salmon L.J. in the *Pilkington* case (*supra*, at p. 35):

"I do not read.... the decision of Mr. Justice Rowlatt in the *Rand* case as laying down a proposition of law to the effect that whenever a property owner develops his land by making roads and laying sewers and selling plots, he can never be carrying on a trade. This would be opening the door very wide to modern property developers. I think that the highest it can be put is that usually in such circumstances the property owner is not carrying on a trade, but whether in the particular case he is or is not doing so must depend on the facts of the particular case. It is essentially a question of fact and degree".

Lastly, the mere fact that the proceeds of the realisation of immovable property, which has increased in value, have been used for the acquisition of other income-producing property, does not seem to be a factor of a decisive nature, if otherwise a conclusion against the taxpayer is not warranted by the whole circumstances of the particular case. This is to be derived from the *Agrotis* case (*supra* at p. 35) and from *The Limassol Land Investments Ltd.* v. *Commissioner of Income Tax* (22 C.L.R. p. 27).

In view of the annulment, as aforesaid, of the *sub judice* decisions, Respondent 2 has to determine, afresh, in the light of the foregoing principles, and of any other relevant principle or consideration, the objections of the Applicant to the assessments in respect of the years of assessment 1959 and 1961.

Regarding the collateral issue about the validity of the 5% surcharge claimed in respect of the amount of tax finally assessed by means of the decision *exhibit* 1 (under section 33 of Law 53/63) I do not think it needs, any longer, to be resolved, once the said decision has been annulled. If after reconsideration of the relevant objection of Applicant, Respondent 2 decides to reject it, and to impose also the said surcharge, then this issue can be raised afresh by Applicant, by making a new recourse.

In all the circumstances of this Case I think the Applicant is entitled to part of his costs, which I assess at £18.

Decision complained of declared null and void. Order for costs as aforesaid.