[A. LOIZOU, J.]

IN THE MATTER OF ARTICLE 146 OF THE CONSTITUTION

VITA - ORA CO. LTD.,

Applicant,

and

THE REPUBLIC OF CYPRUS, THROUGH

1. THE MINISTER OF FINANCE,
2. THE DIRECTOR OF THE DEPARTMENT OF INLAND REVENUE,

Respondents.

(Case No. 9/72).

Income Tax—Private Company—Loan to company Director —Ordinary business of Company not including lending of money—Requirement of paragraph 2(a) of the Second Schedule to the Income Tax Laws 1961 - 1969 not satisfied—Consequently, the relevant amount (in the present case £4,492) was rightly assessed at 425 mils in every pound, and not as claimed by the applicant Company at 250 mils on every pound—Loan in the present case to the Company Director is unlawful—Section 182(1)(d) of the Companies Law, Cap. 113—In the circumstances of this case, even if the said loan were to be held lawful, still the exception under paragraph 2(a) of the Second Schedule to the Income Tax Laws 1961 - 1969 would not cover the loan in question —Because such loan could not be said to have been made for the purposes of the Company.

Statutes—Construction—"To be kept in the Company and used for its purposes" *in paragraph 2(a) of the Second Schedule to the Income Tax Laws 1961 - 1969.*

Companies Law—Lending of money—Lending money to Company Director—When lawful—Section 182(d) of the Companies Law, Cap. 113—When lending of money is part of the Company's ordinary business—Lending money in the case of the applicant company is one

of the powers given to it to achieve its objects—And not one of its objects.

Words and Phrases—"Transferred to its reserve capital and is kept in the Company and used for its purposes"—Paragraph 2(a) of the Second Schedule to the Income Tax Laws 1961 - 1969.

Words and Phrases—"... company whose ordinary business includes the lending of money or ...., to anything done by the Company in the ordinary course of that business"—That means that the lending of money must be part of the company's ordinary "business"—Section 182(1)(d) of the Companies Law, Cap. 113.

By this recourse under Article 146 of the Constitution the applicant company challenged the validity of the income tax assessment raised upon them for the year of assessment 1969—year of income 1968—claiming that their income for that year amounting to £4,492 should have been taxed at the reduced rate of 250 mils in the pound, and not at 425 mils in the pound as it was done by the respondents, on the ground that all the requirements of paragraph 2 of the Second Schedule to the Income Tax Laws 1961 - 1969, which governs the matter, are fully satisfied. (*Note:* paragraph 2 is set out *post* in the Judgment and its relevant parts are quoted immediately herebelow)

The Second Schedule to the Income Tax Laws 1961 - 1969 gives the rates of tax payable on chargeable income and paragraph 2 thereof is in the following terms:

> "2. Companies... shall pay tax at *the rate of four hundred and twenty-five mils on every pound of chargeable income:*
>
> Provided that in cases where the chargeable income of a company incorporated and registered in the Republic, which is derived from the sources specified in paragraphs (a) and (b) of sub-section (1) of section 5, not including interest, dividends and rents —
>
> (a) does not exceed the sum of £7,000, an amount of up to £5,000 of the said income, which is transferred to its *reserve capital and is kept in the company and used for its purposes shall be taxed at the rate of 250 mils* on every pound.

(b) .. . .

. . . .

Provided further that in the event of the company being liquidated, the total of the capital reserve of any trading period, which was taxed at the rate of 250 mils in every pound, may be deemed to be income in the year in which such company is liquidated and shall be taxed at the *rate of 175 mils on every pound.*"

It is not disputed that the aforesaid amount of £4,492 is derived from sources specified in paragraphs (a) and (g) of sub-section 1 of section 5 of the Law referred to hereinabove.

What the applicants are saying is briefly this: The aforesaid sum of £4,492 was duly transferred to the reserve capital of the company and was kept and used for one of the purposes of the company *viz.* for a loan to one of its directors. The objects of the company cover a wide range and are to be found in 22 paragraphs of the Memorandum. Paragraph 8 reads: "To lend money to such persons or companies and on such terms as may seem expedient and in particular to customers and others having dealings with the company". Be that as it may, it would seem that the company is a manufacturing and canning company; and it has been conceded that there has been no other lending since its incorporation *circa* 1960 except loans to the aforesaid Director, which started in 1961 with an amount of £354 and were steadily increasing without any repayment to the company being made; and by 1968 such loans reached the figure of £30,707.

The learned Judge, dismissing the recourse by the taxpayer company, held that:-

(a) the aforesaid sum of £4,492 cannot be said, in the circumstances of this case, to have been transferred to the reserve capital of the company;

(b) nor was it used for the purposes of the company, and

(c) in any case, the loan in question to the aforesaid Director is unlawful under section 182(1) of the Companies Law, Cap. 113, the proviso (d) thereto not covering the loan or loans in question.

Section 182(1) of the Companies Law, Cap. 113, provides:

"182(1) It shall not be lawful for a company to make a loan to any person who is its director or a director of its holding company, or to enter into any guarantee or provide any security in connection with a loan made to such a person as aforesaid by any other person:

Provided that nothing in this section shall apply either —

(a) to anything done by a company which is for the time being an exempt private company; or

(b) . , or

(c) , or

(d) in the case of a *company whose ordinary business includes the lending of money* or the giving of guaran'ees in connection with loans made by other persons, *to anything done by the company in the ordinary course of that business.*"

Dismissing the recourse, the learned Judge :-

Held, (1). Two points have to be determined in the present case The first one is whether an amount up to £5,000 of the applicant company's income has been transferred to its *"reserve capital"* and is kept in the company and secondly whether that amount "is kept and used for its purposes".

(2) For the purposes of interpreting the words "reserve capital" to be found in paragraph 2(a) of the Second Schedule to the Income Tax Laws 1961 - 1969 (*supra*), one has to turn to the general principles of the law governing the interpretation of statutes rather than to any particular use made either under accountancy practices or in the various sections or schedules of the Companies Law.

(3) (a) The meaning to be ascribed to the word "reserve capital" has to be derived from the context in which this expression is used in relation to the remaining requirement of the

section, that is to say *"to be kept in the company and used for its purposes"*. Therefore, they must be construed in the sense of non-distributed profits which are intended to be used for the purposes of the company. Merely leaving it in the Profit and Loss Account is not enough; something more has to be done, so that it can be easily identified and in the event of the company being liquidated, the total of the "capital reserve" of any trading period which was taxed at the rate of 250 mils on every Pound, and be deemed to be income for the year in which such company is liquidated and taxed at the rate of 175 mils on every Pound, as provided by the second proviso to paragraph 2 of the Second Schedule (*supra*).

It is obvious that this is a provision to facilitate small companies to expand their business by being given additional benefits or tax reliefs in cases where they plough back into the business their profits.

(b) The inclusion of this amount (*viz.* the said £4,492) in the Profit and Loss Account in the way it was done in the present case, does not satisfy the requirement of the Law for "the transfer of the amount to the reserve capital of the company".

(4) The point, however, that really determines the present case, is whether the aforesaid amount of £4,492 has been used for the purposes of the company. It goes without saying that this requirement cannot be fulfilled if the loan (or loans) in question to the said Director is (or are) unlawful under section 182(1) of the Companies Law, Cap. 113 (*supra*).

(5) (a) It is not disputed that the applicant Company is a manufacturing company and it has been conceded that there has been no other lending except the one under consideration to the said Director.

(b) Now, the rule is that "it shall not be lawful

for a company to make a loan to any person who is its director...", provided this rule does not apply, *inter alia,* "in the case of a company whose *ordinary business* includes the *lending* of money..., to anything done by the company *in the ordinary course of that business*". (See section 182(1)(d) of the Companies Law, Cap. 113, *supra*).

(c) To my mind, the words "whose ordinary business includes the lending of money" in section 182(1)(d) (*supra*), cannot be given a different interpretation and should not convey a different meaning from the words "where the lending of money is part of the ordinary business of a company" (see *Steen* v. *Law* [1964] A.C. 287, at pp. 301—302).

(d) But in the case of the applicant company it cannot be said that its ordinary business includes the lending of money in the sense that this expression has been interpreted in the *Steen* case (*supra*).

(e) Therefore, the lending of money to its director is unlawful. That being so, the words "used for its purposes" in paragraph 2(a) of the Second Schedule to the Income Tax Laws 1961—1969 (*supra*) could not be intended to include an unlawful purpose such as unlawful lending of money to one of its directors.

(6) (a) In my view, even if the lending of money was to be considered as lawful, I am not prepared in the present case to accept that the words *"used for its purposes"* read in conjunction with the preceding condition of the transfer "to its reserve capital and kept in the company" can, on their true construction, cover such lending. "Used for its purposes" means for the purpose of the company which, in the present case, are those of manufacturing and trading, and not of banker and money-lender. And a difference should be drawn between the objects of the Company and the

powers given to it to achieve those objects. The power to lend money found in paragraph 8 of the objects of the Memorandum (*supra*), is not on the true construction of the said document, one of the objects of the Company, but one of the powers given to it to achieve those objects. It is an ancillary power to the main objects and limited and controlled thereby.

(b) In my judgment, the said paragraph 8 (*supra*) does not satisfy the requirement of paragraph 2 of the Second Schedule to the Income Tax Laws 1961—1969 (*supra*) that the money lent to its Director was a use for the purposes of the Company.

Recourse dismissed.
No order as to costs.

The facts sufficiently appear in the judgment of the learned Judge, dismissing this recourse against the income tax assessment for the year of income 1968 made on the applicant Company.

Cases referred to:

Re Hoare Co. Limited and Reduced [1904] 2 Ch. 208 C.A.;

Louis Steen and Another v. *Charles Allen Law etc* [1964] A.C. 287, at pp. 301, 302;

Scott v. *Corporation of Liverpool*, cited in Palmer's Company Law, 21st edition, at p. 84

Recourse.

Recourse against the validity of an income tax assessment raised on applicant for the year of assessment 1969.

C. Indianos, for the applicant.

A. Evangelou, for the respondents.

Cur. adv. vult.

The following judgment * was delivered by :-

A. LOIZOU, J.: By the present recourse the income tax assessment made on the Applicant Company for the year of assessment 1969—year of income 1968— is sought to be declared null and void; it is hereby claimed that the Applicant Company should have been taxed at the reduced rate of 250 mils in the Pound and not at 425 mils in the Pound, as satisfying all the requirements of paragraph 2 of the Second Schedule to the Income Tax Laws of 1961—1969 which governs this matter.

The Applicant Company was incorporated in Cyprus on the 8th January, 1952, having its registered office and canning factory in Famagusta. It is a private company, but not an exempted private one, as it appears from the certificate of the Official Receiver and Registrar of Companies, (*exhibit* 6).

The Memorandum and Articles of Association of the Company have been produced as *exhibit* 4 and reference will be made to their relevant parts. The Company's business is that of canning and export of fruit juices and vegetables and it is not in dispute that its income is derived from these sources but it has been claimed that lending of money is included in the purposes of the Company.

The objects of the Company, as appearing in paragraph 3 of the Memorandum, cover a wide range and are to be found in 22 paragraphs. Paragraph S reads:- "To lend money to such persons or companies and on such terms, as may seem expedient and in particular to customers and others having dealings with the Company", but I shall revert to it later.

According to the Balance Sheet and Profit and Loss Account and computation of income (*exhibits* 2 & 3), the Company's assessable income for the year of assessment 1969—year of income 1968—amounted to £4,492. The assessment on the Company was raised on the 25th October, 1969 at the rate of 425 mils in the Pound. On the 7th November, 1969 the applicant Company, through

* For final judgment on appeal see (1975) 8 J.S.C. 1143 to be published in due course in (1973) 3 C.L.R.

its auditors, objected to the aforesaid assessment, asking that the tax be assessed at the rate of 250 mils in the Pound. The objection was rejected, as it appears from the communication of same, of the 1st July, 1970, Appendix "B" attached to the opposition, and in paragraph 4 thereof, it is stated :- "*Rate of tax 250 mils as claimed by you.* My view is that, in view of Directors drawings £6,545 which exceed the year's profit of £4,492, the correct rate applicable is 425 mils, because the profits did not stay in the business but went out in the form of loan to Directors".

It may be useful to give particulars of the shareholding of the Company and the loan to the Director involved, namely, Moshe Aharoni who resides abroad. He is one of the shareholders and Directors of the Company with a holding of 40 Founder Shares and 230 Ordinary Shares out of a total of 120 Founder Shares and 3,993 Ordinary Shares. From the accounts of the Company it appears that the Company granted loans to the said Director on various dates, the first record appearing on the 30th September, 1961, the date on which the Company submits annually its accounts, the amount due then being £364. This amount was steadily increasing every year without any repayment to the Company being made. By the 30th September, 1967, it reached the figure of £24,162 and in 1968 £30,707.

The Second Schedule to the Law gives the scale of rates of tax payable on chargeable income and paragraph 2 thereof is in the following terms :

> "2. Companies and all other bodies corporate or unincorporate shall pay tax at the rate of four hundred and twenty-five mils on every pound of chargeable income :
>
> Provided that in cases where the chargeable income of a company incorporated and registered in the Republic, which is derived from the sources specified in paragraphs (a) and (g) of sub-section (1) of section 5, not including interest, dividends and rents —
>
> (a) does not exceed the sum of £7,000, an amount of up to £5,000 of the said income,

which is transferred to its reserve capital and is kept in the company and used for its purposes shall be taxed at the rate of 250 mils on every pound;

(b) exceeds the sum of £7,000, but does not exceed the sum of £8,500, the tax payable shall, subject to the provisions of paragraph (a) above, be equal to the sum of the tax payable on a chargeable income of £7,000 and of the amount by which the chargeable income exceeds the sum of £7,000;

Provided further that in the event of the company being liquidated, the total of the capital reserve of any trading period, which was taxed at the rate of 250 mils on every pound, may be deemed to be income in the year in which such company is liquidated and shall be taxed at the rate of 175 mils on every pound."

The sources of income covered by paragraphs (a) and (g) of sub-section (1) of section 5 of the Law referred to hereinabove, are gains of profits from any trade, business, profession or vocation for whatever period of time such trade, business, profession or vocation may have been carried on or exercised and profits from agriculture, animal husbandry business, including other share of profit or other consideration received or payable in respect of the use of capital, property; seed or stock for the purposes of the use in such business of such capital, property, seed or stock. The rents, dividends and interest come under different paragraphs.

Two points have to be determined in the present recourse. The first one is whether an amount up to £5,000 of the said income has been transferred to its reserve capital and is kept in the company and secondly whether that amount "is kept and used for its purposes".

Regarding the first point, arguments have been advanced and evidence was called on behalf of the applicant Company to the effect that the inclusion of assessable income in the Profit and Loss Account amounts, according to the principles of commercial accountancy, to a transfer to the Company's reserves or reserve fund. In

fact, the words "reserve capital" have been described as a misnomer. Reference was made in support of this proposition to Charlesworth's Company Law, 9th Edition, page 129, where "reserve capital" is described as—"that part of the uncalled capital which a limited company has by special resolution determined, shall not be called up, except in the event and for the purposes of the Company being wound up and which cannot otherwise be called up: s. 60."

Section 60 of the English Companies Act of 1948 corresponds to our section 59. The marginal notes to both sections being "reserve liability of company". As stated in Palmer's Company Law, 21st Edition, p. 264 under the heading Reserve Liability—".... This amount resolved by the company to meet a contingency in the winding up is sometimes called "the reserve capital". although the Act uses a more accurate term—"reserve liability". I need not emphasize that the expression "reserve capital" is mentioned hereinabove as "sometimes" called so. Under the Companies Law, section 151(1) and the Eighth Schedule thereto, provisions as to Balance Sheets and Profit and Loss Accounts are made. Relevant are paragraphs 4(1) and 27(1) of the said Schedule, the latter being the definition part and the expression "capital reserve" is defined therein as not including any amount regarded as free for distribution through the Profit and Loss Account and the expression "revenue reserve" shall mean any reserve other than capital reserve.

The creation of reserve funds is envisaged also by the First Schedule to the Law, Table A, Article 117 which corresponds to identical English provisions. But a reserve fund so created, may at any time be distributed as dividend or employed in any other way authorised by the Articles and as stated in the case of *Re Hoare & Co. Limited and Reduced* [1904] 2 Ch. 208, C.A. the fact that it has been used in the business does not show that it has been capitalized so as not to be available for dividend. It is obvious from the aforesaid passages and definitions and use made of the expression "reserve capital" that it is differently understood in the different contexts that it is used.

Therefore, in the present case and for the purposes

of interpreting the words "reserve capital" to be found in paragraph 2(a) of the Second Schedule to the Income Tax Laws 1961 to 1969, one has to turn to the general principles of the Law on the Interpretation of Statutes than to any particular use made either under accountancy practices or in various sections or schedules of the Companies Law.

In Halsbury's Laws of England, Third Edition, Vol. 36, paragraph 593, it is stated:-

> "The words of a statute are normally to be construed in their ordinary meaning, though due regard must be had to their subject matter and object and to the occasion on which and the circumstances with reference to which they are used and they should be construed in the light of their context rather than in what may be either their strict etymological sense or their popular meaning apart from that context."

The meaning to be ascribed to the word "reserve capital" has to be derived from the context in which this expression is used in relation to the remaining requirement of the section, that is to say, "to be kept in the Company and used for its purposes". Therefore, they must be construed in the sense of non-distributed profits which are intended to be used for the purposes of the Company. Merely leaving it in the Profit and Loss Account is not enough; something more has to be done, so that it can be easily identified and in the event of the Company being liquidated, the total of the capital reserve of any trading period which was taxed at the rate of 250 mils on every Pound, and be deemed to be income for the year in which such Company is liquidated and taxed at the rate of 175 mils on every Pound, as provided by the second proviso to paragraph 2 of the Second Schedule. It is obvious that this is a provision to facilitate small companies to expand their business by being given additional benefits or tax reliefs in cases where they plough back into the business their profits. The inclusion of this amount in the Profit and Loss Account in the way it was done in the present case, does not satisfy the requirement of the Law for "the transfer of the amount to the reserve capital of the company."

The point, however, that really determines the present case, is whether the amount has been used for the Company's purposes. Section 182 of the Companies Law, corresponds to section 190 of the English Act of 1948 and in so far as relevant to this issue, reads as follows:-

"182.(1) It shall not be lawful for a company to make a loan to any person who is its director or a director of its holding company, or to enter into any guarantee or provide any security in connection with a loan made to such a person as aforesaid by any other person:

Provided that nothing in this section shall apply either —

(a) to anything done by a company which is for the time being an exempt private company; or

(b) to anything done by a subsidiary, where the director is its holding company; or

(c) subject to subsection (2) to anything done to provide any such person as aforesaid with funds to meet expenditure incurred or to be incurred by him for the purposes of the company or for the purpose of enabling him properly to perform his duties as an officer of the company; or

(d) in the case of a company whose ordinary business includes the lending of money or the giving of guarantees in connection with loans made by other persons, to anything done by the company in the ordinary course of that business.

(2)

(3)

It has been submitted by learned counsel for the respondents that the lending of money by the applicant Company to one of its directors is an unlawful purpose. For this purpose, it has to be considered whether the loan made to the Director falls within the exception of paragraph (d) hereinabove, in the sense that the applicant

Company is a company whose "ordinary business" includes the lending of money.

On the other hand, in support of the view that the lending of money is included in the ordinary business of the applicant Company, its learned counsel has referred me to paragraph 3(s) of the Memorandum of Association which has been set out hereinabove verbatim and it was urged that the words "for its purposes" appearing in paragraph 2(a) of the Second Schedule, do not only cover the main object, but mean any of the objects of the Company.

It has already been said that the Company is a manufacturing company and it has been conceded that there has been no other lending, except the one under consideration.

In due course I shall deal with the effect of the objects clause in the Memorandum of Association (*exhibit* 4). At present, I shall refer to the case of *Louis Steen and Another* v. *Charles Allen Law, etc.* [1964] A.C. p. 287, a Privy Council case where the words—"the lending of money is part of the ordinary business of a company, the lending by a company of money in the ordinary course of its business" to be found in the proviso to section 148 of the Companies Act, 1936, New South Wales, were interpreted and held that the lending of money to be part of the ordinary business of a company must be a lending of money in general, in the sense that money lending was part of the ordinary business of a registered money-lender or a Bank. The said proviso is identical to paragraph (a) of the proviso to section 53(1) of our Companies Law.

Viscount Radcliffe in giving the judgment of the Court at pages 301 and 302, says :-

> "Even so, the qualification is imposed that, to escape liability, the loan transaction must be made in the ordinary course of its business. Nothing therefore, is protected except what is consistent with the normal course of its business and is lending of a kind which the company ordinarily practises.
>
> In Their Lordships' opinion such an approach to the interpretation of proviso (a) necessarily re-

quires that the 'lending of money' to be part of the ordinary business of a company, must be what may be called a lending of money in general, in the sense for example, that money-lending is part of the ordinary business of a registered money-lender or a bank. Such lenders are not obliged to accept their borrowers; but it is characteristic of their business that, if they do lend, the money made available is at the borrower's free disposition and is not, except in special circumstances confined to special uses or restricted to particular and defined purposes."

And further down, it says —

"Thus a company which, for instance, lent money from time to time to trade suppliers or purchasers could claim that the lending of money was part of its ordinary business and that it was accordingly one of the companies intended to be protected by proviso (a), if it chose to make loans in connection with the purchase of its shares. Yet, it intended to provide any exemption or relief for such cases, for there could be no good reason for allowing a company to use previous lendings for quite different purposes as the justification for share purchase loans, which the legislation is in general intended to forbid."

The words "whose ordinary business includes the lending of money" in section 182(1)(d) of Cap. 113, cannot be given, to my mind, a different interpretation and should not convey a different meaning from the words "where the lending of money is part of the ordinary business of a company".

What has been stated in the case of *Steen* v. *Law* (*supra*) applies to the words under construction in paragraph (d) hereof. In fact, the case of *Steen* v. *Law* is given in Palmer's Company Law, as an authority for the interpretation of section 190(1)(d) of the English Act of 1948 where the comment in the said textbook regarding section 190 is as follows -

"The section admits, however, a number of exceptions to this prohibition: (1) The prohibition

does not apply to loans made in the ordinary course of business by a company whose ordinary business includes lending of money, e.g. by a bank. *(Steen* v. *Law,* section 190(1)(d))."

In the case of the applicant Company it cannot be said that its ordinary business includes the lending of money in the sense that this expression has been interpreted in the *Steen* case (*supra*). Therefore, the lending of money to its director is unlawful.

This being so, the words "used for its purposes" (hrisimopiite thia tous skopous aftis) could not be intended to include an unlawful purpose such as unlawful lending of money to one of its directors.

In my view, even if the lending of money was to be considered as lawful, in the present case I am not prepared to accept that the words "used for its purposes" read in conjunction with the preceding condition of the transfer "to its reserve capital and kept in the company" can, on their true construction, cover such lending. "Used for its purposes" means for the purposes of the company which, in the present case, are those of manufacturing and trading and not of banker and money-lender. Furthermore, whether the lending of money is or is not within the powers of the Company, is a question of law, depending on the construction to be placed on the objects clause of the Memorandum of Association. As stated in Palmer's Company Law, 21st edition, p. 84, "To construe a document is, as Lord Chelmsford said in *Scott* v. *Corporation of Liverpool,* nothing more than this; to arrive at the meaning of the parties".

A difference should be drawn between the objects of the Company and the powers given to it to achieve those objects. The power to lend found in paragraph (s) of the Objects of the Memorandum, is not on the true construction of the said document, one of the objects of the Company, but one of the powers given to it to achieve those objects. It is an ancillary power to the main objects and limited and controlled thereby. The said paragraph (s) of the objects clause even when read in isolation, does not appear to give the Company power to carry on an independent business of money lending, because from its own wording, the intention appears

that the lending of money is limited—"as may seem expedient and in particular to customers and others having dealings with the Company". Independently, however, of this, read in conjunction with the main objects, it confers merely a power to do a limited class of acts with a view to carrying out the main objects. In my judgment, it does not satisfy the requirement of paragraph 2 of the Second Schedule to the Income Tax Laws that the money lent to its Director was a use for the purposes of the Company.

For the above reasons, the present recourse is dismissed with no order as to costs.

Application dismissed.
No order as to costs.