1983 May 28

[PIKIS, J.]

IN THE MATTER OF ARTICLE 146 OF THE CONSTITUTION

BANK OF CYPRUS (HOLDINGS) LTD.,
Applicants,

v.

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

(*Case No.* 26/82).

Company Law—Principle in Salomon *v.* Salomon [1897] *A.C.* 22 *that a company has a personality separate and independent from that of its shareholders—Exceptions to the principle have no application to the facts of this case—Parent Company and subsidiary companies—Income earned by the latter in* 1973 *before their take over by the parent company accumulated in a reserve fund and bearing income tax—A dividend declared out of this fund in* 1978 *and paid to the parent company as shareholder of the subsidiary company—No rule that the distribution of the income of a subsidiary after tax is not liable to the tax legislation at a subsequent time if distributed as dividend.*

The applicant company was incorporated in the year 1973 and became a legal entity mainly for the purpose of taking over the Bank of Cyprus Limited and the Bank of Cyprus Finance Corporation Limited as well as other sister companies of the subsidiaries.

At the time of the take-over the Bank of Cyprus Ltd. and the Bank of Cyprus Finance Corporation Ltd., had funds held in a reserve fund, accumulated from profits of the companies in the year 1973. They derived from the declared income of the companies and bore income tax according to law. The monies could be distributed to shareholders at the discretion

of these companies without incurring any further liability to income tax. Nevertheless they were not distributed before the take-over and were held in a special reserve fund, a fund primarily designed to enable the companies to meet ordinary or extraordinary liabilities or be made available wholly or in part for distribution to shareholders.

Because of the Turkish invasion and its devastating effects the applicants suffered serious losses, making it impossible to pay dividends to shareholders out of profits from trading or other activities after 1974. The huge losses incurred by reason of the Turkish invasion made that impossible. In 1978 the applicants took a policy decision that time was ripe for the payment of dividend to their shareholders. This decision was implemented by the Board of the Bank of Cyprus declaring a dividend to its shareholders, the applicants. In accordance with the wishes of the parent company, a dividend was declared out of the reserve fund made up of profits earned prior to 1974. A dividend of £476,000.- was paid to the applicants by the aforementioned two subsidiaries.

The Commissioner of Inland Revenue held the dividend to be liable to special contribution in accordance with the provisions of the Special Contribution (Temporary Provisions) Law 1974-55/74 and levied by way of special contribution a tax of £118,967.450 mils.

Hence this recourse in which the sole issue was whether it was permissible to go behind the separateness in law of the Bank of Cyprus (Holdings) Ltd. from its subsidiaries—the Bank of Cyprus Limited and the Bank of Cyprus Finance Corporation Limited—and treat the income of the latter, earned before their take-over by the parent company and accumulated in a reserve fund, as income of the Holding Company.

Counsel for the applicants mainly contended that having regard to the history of amalgamation and the relationship with their subsidiaries, this income should be treated in law as being their own all along, notwithstanding the separateness in law of the applicants and their subsidiaries. The principle in *Salomon* v. *Salomon* [1897] A.C. 22, that a company has a personality separate and independent from that of its shareholders should have no application in this case.

Held, that the applicants had a different identity from its subsidiaries and they had different purposes and objectives because they were not a banking corporation like the Bank of Cyprus Limited, or a finance corporation like the Bank of Cyprus Finance Corporation Limited and their activities were different and their Boards were not identical; that all these factors serve to stress the separateness of the three companies; that the formation of the Holding Company and subsequent take-overs were undertaken as part of a long term project, presumably advantageous to all concerned; and they have to live with the disadvantages as well; that there is no room whatever for holding that the reserve fund in question of the subsidiaries was held on trust for the applicants and it was very much in law the property of the subsidiaries; that there is no intrinsic injustice in sustaining the separateness of the companies as the law requires; that the submissions relevant to double taxation have no validity; that what was taxed was the income of the Holdings in 1978; that the dividend derived from the income of a subsidiary that could not have been subjected to special contribution at the time of its earning is totally irrelevant; that there is no rule that the distribution of the income of a subsidiary after tax is not liable to the tax legislation at a subsequent time if distributed as dividend; that though the Courts may refuse to apply the principle of separateness of a corporate body from its shareholders (see the *Salomon* case, supra) if too flagrantly opposed to justice, convenience, or the interests of the revenue, the facts of this case do not fit into any of the exceptions to this principle; accordingly the recourse should fail.

Recourse dismissed.

Cases referred to:

Antoniades v. *Republic* (1979) 3 C.L.R. 641;

Republic v. *Pavlides and Others* (1979) 3 C.L.R. 603;

Salomon v. *Salomon* [1897] A.C. 22;

Georghiades v. *Republic* (1982) 3 C.L.R. 659;

D.H.N. Food Distributors Ltd. v. *Borough of Tower Hamlets* [1976] 3 All E.R. 462 (C.A.);

Smith, Stone and Knight Ltd. v. *Lord Mayor* [1939] 4 All E.R. 116;

Littlewoods Mail Orders Stores v. *I.R.C.* [1969] 1 W.L.R. 1241 (C.A.);

Lourho Ltd. v. *Shell Petroleum* [1980] 2 W.L.R. 367;

Michaelides v. *Gavrielides* (1980) 1 C.L.R. 244;

Patel v. *I.R.C.* [1971] 2 All E.R.504; [1971] 46 T.C.658;

Tunstall v. *Steigmann* [1962] 2 All E.R. 417.

Recourse.

Recourse against the decision of the respondents to hold the dividend of £476,000.- paid to applicant by its subsidiaries as liable to special contribution in accordance with the provisions of the Special Contributions (Temporary Provisions) Law, 1974 (Law No. 55/74) and to impose on applicants by way of special contribution a tax of £118,967.450 mils.

P. Polyviou, for the applicants.

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

Cur. adv. vult.

PIKIS J. read the following judgment. A novel but otherwise straight forward question must be answered. It is this:

Whether it is permissible to go behind the separateness in law of the Bank of Cyprus (Holdings) Ltd. from its subsidiaries - the Bank of Cyprus Limited and the Bank of Cyprus Finance Corporation Limited - and treat the income of the latter, earned before their take-over by the parent company and accumulated in a reserve fund, as income of the Holdings Company.

The applicant company was incorporated in the year 1973 and became a legal entity, mainly for the purpose of taking over the aforementioned subsidiaries, as well as other sister companies of the subsidiaries, including the General Insurance Company of Cyprus Limited. Apparently the arrangement was considered financially advantageous. The idea behind was to form an investment company that would control the Bank of Cyprus Limited and associate companies with power to dictate the po-

licy and monitor the activities of subordinate companies. We can legitimately presume the objects of the Holding Company and the subsidiaries were different, especially those of the Bank of Cyprus Ltd., a banking institution with deep roots in the economic life of the country. The arrangement enabled the Bank of Cyprus Ltd. to retain its link with the past while subordinating it to the Holding Company.

The history of the take-over - of what I may call the Bank of Cyprus Group - by the applicants and facts relevant to the dispute of the parties, is minuted in an agreed statement of facts commendably prepared by counsel for the simplification and elucidation of the issues in dispute.

At the time of the take-over the Bank of Cyprus Ltd. and the Bank of Cyprus Finance Corporation Ltd., had funds held in a reserve fund, accumulated from profits of the companies in the year 1973. They derived from the declared income of the companies and bore income tax according to law. The monies could be distributed to shareholders at the discretion of these companies without incurring any further liability to income tax. Nevertheless they were not distributed before the take-over and were held in a special reserve fund, a fund primarily designed to enable the companies to meet ordinary or extraordinary liabilities or be made available wholly or in part for distribution to shareholders.

Because of the Turkish invasion and its devastating effects, the applicants suffered serious losses, making it impossible to pay dividends to shareholders out of profits from trading or other activities after 1974. The huge losses incurred by reason of the Turkish invasion made that impossible. In 1978 the applicants took a policy decision that time was ripe for the payment of dividend to their shareholders. This decision was implemented by the Board of the Bank of Cyprus declaring a dividend to its shareholders, the applicants. In accordance with the wishes of the parent company, a dividend was declared out of the reserve fund made up of profits earned prior to 1974. A dividend of £476,000.- was paid to the applicants by the aforementioned two subsidiaries.

The Commissioner of Inland Revenue held the dividend to be liable to special contribution in accordance with the provisions

of the Special Contribution (Temporary Provisions) Law 1974 - 55/74 and levied by way of special contribution a tax of £118,967. 450 mils. Law 55/74 was one of a series of laws enacted after the Turkish invasion in order to enable the Government to raise revenue for the extraordinary social needs of the country. As the long title of the enactment suggests, it is legislation of a temporary character designed to tidy over a grave emergency. The law was challenged on grounds of constitutionality albeit without success. (See, *Antoniades and Others v. The Republic* (1979) 3 C.L.R. 641 - *Republic v. Pavlides and Others* (1979) 3 C.L.R. 603). Section 3 of the law makes liable, on a quarterly basis, to special contribution, every form of income other than income from an Office or employment. It has not been suggested that the dividend received by applicants was anything other than income in its hands. The gravamen of their case is that having regard to the history of amalgamation and the relationship with their subsidiaries, this income should be treated in law as being their own all along, notwithstanding the separateness in law of the applicants and their subsidiaries. The principle in *Salomon v. Salomon* [1897] A.C. 22, that a company has a personality separate and independent from that of its shareholders, a principle that has dominated company law thinking ever since, should have no application in this case.

A number of English decisions mostly recent, have admitted exceptions to the rule in *Salomon,* above mentioned. Relying upon this body of caselaw, applicants argued that ignoring the separateness of the applicants from their subsidiaries in the circumstances of their relationship, is consistent with the exceptions to the rule in *Salomon;* in fact, warranted by them. The burden is on the applicants, as in every other case of administrative review, to satisfy the Court that the decision of the respondents was ill-founded and wrong in law (see, *Lilian Georghiades v. The Republic* (1982) 3 C.L.R. 659).

The separateness in law of a company from its shareholders is the basic concept underlying corporateness and the feature that distinguishes a company from a partnership and other unincorporated bodies. It is not for me to debate either the wisdom or commercial significance of the rule. Certainly the principle has stood the test of time and, its adoption made possible in the case of public companies the pulling of resources

that might not otherwise be feasible. Learned counsel for the applicants has not questioned the soundness of the rule in *Salomon,* only its universality. Under certain circumstances, he argued on authority, it is possible to bypass or circumvent the separateness of a company from its shareholders by a process of lifting or piercing the veil of incorporation that prevents their assimilation.

The essence of the case for the applicants is that the nexus between them and their subsidiaries and, their relationship with regard to the keeping in tact of the reserve fund is such as to justify in law the treatment of the reserve fund as their property albeit held in reserve on their behalf by their subsidiaries. Counsel discussed at length, on their behalf, the implications of a number of cases establishing exceptions to the rule in *Salomon,* in an effort to persuade me that it is legitimate to follow in this case the exception to the rule. The principal cases discussed are - *D.H.N. Food Distributors Ltd. v. Borough of Tower Hamlets* [1976] 3 All E.R. 462 (C.A.); *Smith, Stone and Knight Ltd. v. Lord Mayor* [1939] 4 All E.R. 116; *Littlewoods Mail Order Stores v. I.R.C.* [1969] 1 W.L.R. 1241 (C.A.); *Lonrho Ltd. v. Shell Petroleum* [1980] 2 W.L.R. 367. In his submission the decision of the Supreme Court in *Michaelides v. Gavrielides* (1980) 1 C.L.R. 244, does not make inapplicable in Cyprus the exceptions to the rule but merely affirms the principle in *Salomon.*

Mr. Evangelou resisted the submissions of the applicants and argued that whatever may be the purport and ambit of the exceptions to the rule in *Salomon,* they are, on analysis of the authorities relied upon by counsel, inapplicable to the facts of the case. The dividend declared by the subsidiaries became for the first time the income of the parent company in 1978 and not earlier. He pointed out that at no time prior to 1978 was the reserve fund in question, or any part of it, treated as the profit of the Holding Company. Summarising his submissions, any attempt to lift the corporate veil in this case would be arbitrary and contrary to principle. Relying on the authority of *Patel v. I.R.C.* [1971] 2 All E.R. 504 - [1971] 46 T.C. 658, and the well known textbook on Taxation, *Simon's Taxes,* 3rd ed., Part D, 116, he submitted that dividends are not due until paid. The obligation to pay a special contribution arose for the first time upon receipt of the dividend and not earlier. He refuted every

suggestion that we are before a case of double taxation, pointing out that the dividend in question was never made subject to a special contribution nor was special contribution imposed twice. Moreover, the special contribution tax is a species of taxation, separate and distinct from income tax. He pointed out a number of special features of the tax imposed by the 1974 legislation that distinguish it from income tax.

At the end of the day counsel for the applicants laid emphasis more than anything else on the equitable nature of the case of the applicants, making it just in the light of the exceptions to the rule in *Salomon* to pierce the veil or part of it so as to allow the applicants, a badly stricken company from the tragic events of 1974, to treat the income of their subsidiaries, earned before the take-over, as their own, as in fact it was. Notwithstanding conceptual objections, the receipt of dividend from a subsidiary is regarded as income in the hands of the Holding Company (the subject is discussed in detail by *Weinberg* on *Take-Overs and Mergers* (3rd ed.) at p.1906 et seq.). And this applies to the distribution of pre-acquisition profits as well. The caselaw on the subject enables the applicants to overcome objections that might otherwise be raised to the treatment of pre-acquisition profits as anything other than income. On strict logical analysis unfettered by authority, one might validly argue that every species of asset of a subsidiary is a capital asset of the Holding Company whether held in reserve or distributed.

Piercing the Corporate Veil - Exceptions to the Rule in Salomon - Application to the Facts of the Case:

The protagonist for limiting the absoluteness of the rule in *Salomon* and grafting exceptions to it, has been Lord Denning. As in many other areas of the law, he advocated that no principle is so sacrosanct as to be above justice. Whenever the justice of the case so requires, the corporate veil should be lifted in the interests of justice. In *Littlewoods* supra, at p.1254, he said:

> "The Courts can, and often do, draw aside the veil. They can, and often do, pull off the mask. They look to see what really lies behind."

He proceeded to point out that the legislature itself was active in piercing the corporate veil. Indeed they were. Numerous examples of this are given in *Gower's Principles of Modern Com-*

pany Law, 4th ed., at p.121, under the heading "*Miscellaneous Statutory Examples*". Legislation has been mainly directed towards invalidating the use of incorporation as a device to by-pass the law, mainly revenue laws.

The brethren of Lord Denning on the Court of Appeal have not shown the same enthusiasm for disregarding the principles in *Salomon* whenever it appears just to do so. However, they have, on a number of occasions, concurred or agreed to the lifting of the veil for reasons associated with the intrinsic merits of the case while proclaiming the validity of the rule in *Salomon*. So Courts, like the legislature, have refused to treat the principle of separateness of a corporate body from its shareholders as absolute. Exceptions have been recognised. But going through the authorities, it is difficult, if not impossible, to group them as referable to any distinct exceptional rule. The approach of the Courts is empirical to the point of making it impossible at present to distil therefrom a general rule of exception. Now, we shall look at the cases relevant to the subject, in somewhat greater detail.

1. *The Case of Littlewoods:* Unlike Lord Denning, his fellow Judges on the Bench, Sachs and Karminski, L.Js., refused to acknowledge a general rule of exception to the principle in Salomon whenever it appeared just to do so. They distinctly distanced themselves from the adoption of such a principle. Far from it they pointed out that any attempt to erode the principle in Salomon was disclaimed by the successful appellants. In their opinion, the nature of the transaction was such as to make inconsequential the interposition of a corporate legal entity, solely designed to secure tax advantages for the Holding Company, to the extent of disregarding it. On a study of the facts it appears that a series of transactions between the parent company and its wholly owned subsidiary were exclusively designed to secure tax advantages for the parent company and, as such, they were disregarded. It is important to notice that both Sachs and Karminski, L.JJ., confined this decision to the facts of the case subscribing to the validity of the principle that for tax purposes the tax-payer company and its wholly owned subsidiary are separate legal entities. The facts in *Littlewoods* bear no relationship to the facts of the present case and, in my view, lend little support to the submission of the applicants unless, of course,

we accept the views of Lord Denning, not shared by his brethren, that the principle in Salomon is invariably subject to the justice of a situation. The applicants in the present case were incorporated and took over the subsidiaries in the financial interest of all concerned as a long term project. It was evidently judged necessary to keep the identity of the applicants separate and distinct from the subsidiaries, presumably because it was deemed advantageous to all concerned. Unlike *Littlewoods,* incorporation was not used as a device to secure tax advantages or any other temporary advantage to anyone concerned. The affirmation of the separateness of the tax-payer company from a wholly owned subsidiary for tax purposes by the majority of the Court, far from supporting weakens the case for the applicants.

2. *The D.H.N. Case:* This is the case upon which applicants relied most and sought to derive substantial support. Lord Denning showed equal readiness to lift the corporate veil in the interests of justice but, as in *Littlewoods,* his brethren on the Bench showed equal disinclination to do so. However, the Court was unanimous in its view that the fact of ownership by the subsidiary of premises in the possession of the parent company, should not be allowed to defeat the claim of the parent company for disturbance compensation upon the acquisition of the property. The relationship between the Holding and the subsidiary company was such as to entitle the parent company to be treated as having an irrevocable contractual licence to carry on their business on the premises. This licence entitled them to compensation for their stay was, in the circumstances, more in the nature of permanent possession. The relationship between the Holding and the subsidiary was more in the nature of a partnership and should be heeded as such. Goff and Shaw, L.Js., also rested their judgment in part on the coming into being of a resulting trust in favour of the parent company upon repayment of a loan of the subsidiary.

3. *Smith's Case:* The plotting of the way to the recognition of exceptions to the rule in *Salomon* had been earmarked by Atkinson, J., in *Smith's* case, supra. The case concerned, like *D.H.N.* supra, a claim for disturbance compensation for the acquisition of property. The ratio of the case is that registration of the property in a corporate legal entity, does not conclusively defeat a claim for disturbance compensation by the parent com-

pany. And inasmuch as the subsidiary company was not operating on its behalf but on behalf of the parent company, the claim was sustained. The learned Judge identified six rules of assistance to deciding whether the subsidiary could be ignored. These are, in the words of the Judge -

> "Firstly, were the profits treated as the profits of the company? - when I say 'the company' I mean the parent company - secondly, were the persons conducting the business appointed by the parent company? Thirdly, was the company the head and the brain of the trading venture? Fourthly, did the company govern the adventure, decide what should be done and what capital should be embarked on the venture? Fifthly, did the company make the profits by its skill and direction? Sixthly, was the company in effectual and constant control? "

A comparison of the facts of the case in *Smith* with those of the present case is sufficient to demonstrate the differences between the two cases. In my judgment, the six principles postulated by Atkinson, J., are not satisfied on a review of the facts of the present case. To start with, the profits in question were not treated as the profits of the company, so the facts of the present case fail the first test. Nor were the persons conducting the business of the subsidiaries appointed by the parent company. The applicants fail, in my view, the second test as well and, at least two more of the six postulated criteria - the fifth and the sixth. The parent company did not make the profits by its skill and direction but by that of the Board and team of management of the subsidiaries. Nor is there any suggestion, which is the essence of the sixth test, that the applicants were in effectual and constant control of the activities of the subsidiaries. On the whole, the evidence points to the contrary.

I shall refrain from embarking on detailed examination of other cases cited and, concentrate instead, on the analysis made by *Gower* of the trends emerging from the authorities and their underlying theme. If any consistent principle of exception to the rule in Salomon emerges at all, it is, as the learned authors very rightly notice, this: Courts may refuse to apply the principle in Salomon if too flagrantly opposed to justice, convenience or the interests of the revenue. I subscribe to this view on a study of the caselaw, as well as that advanced later in the

concluding part of the same chapter that "in general, the Courts regard themselves as precluded by *Salomon's* case from treating a company as the 'alias, agent, trustee or nominee' of its members and this is so, whether they are interpreting a statute or dealing with judge-made law."

Courts have shown readiness to lift the veil whenever incorporation is used as a device to secure financial advantages or whenever the interposition of a subsidiary is inconsequential to the nature of the transaction. Departure from the rule in *Salomon* is rare and mostly confined to cases where the interposition of a subsidiary has no real bearing on the nature of transaction. The broad principle upon which Lord Denning advocated the lifting of the corporate veil has not been espoused by the Courts and does not represent the law, either in England or in Cyprus. There is no liberty to depart from the rule in *Salomon* whenever it is just to do so. The matter came up for consideration in *Michaelides v. Gavrielides* (1980) 1 C.L.R. 244, on appeal from the District Court of Larnaca. (I had given the judgment as President of the District Court of Larnaca). The trial Court found that because a family company was solely owned by the son of the landlord and his wife, the landlord could recover possession of premises, in the possession of a tenant, under the provisions of s.16(1)(g) of the Rent Control Law 1975, for making them available for use by his son, treating the family company as nothing other than the agent of the son for the transaction of his business. The Supreme Court reversed the decision and held there was no warrant for treating the shareholders of the private company as identical with the company, an entity separate and distinct in law. They proclaimed the efficacy of the rule in *Salomon* in terms certain, making reference with approval to numerous English decisions, affirming the principle as all important in the field of Company Law (see, inter alia, *Tunstall v. Steigmann* [1962] 2 All E.R. 417). The Supreme Court concluded, at p.258,

> "There is no escape from the fact that a company is a legal entity entirely separate from its corporation."

Further down they stress,

> "even the holder of 100% of the shares in a company does not by that holding become so identified with the

company that it can be said to carry on the business of the company" - See judgment of Hadjianastassiou, J. at p.258.

The judgment of *Michaelides*, supra, cogently affirms the validity of the principle in *Salomon*, leaving little room for the acknowledgment of exceptions to it.

Conclusions:

From the analysis made, it becomes abundantly clear that the facts of this case do not fit into any of the exceptions to the rule in *Salomon* as formulated in the above cases. The applicants had a different identity from its subsidiaries. More important still, it had different purposes and objectives. It was not a banking corporation like the Bank of Cyprus Limited, or a finance corporation like the Bank of Cyprus Finance Corporation Limited. Their activities were different; nor were their Boards identical. Moreover, although the applicants had the amenity to control the policy of the subsidiaries, the implementation of that policy was a matter for the subsidiaries and their team of management. All the aforesaid factors serve to stress the separateness of the three companies. The formation of the Holding Company and subsequent take-overs were undertaken as part of a long term project, presumably advantageous to all concerned. They have to live with the disadvantages as well. There is no room whatever for holding that the reserve fund in question of the subsidiaries was held on trust for the applicants. It was very much in law the property of the subsidiaries. Their amenity to dispose of it by way of dividend was dependent on their financial commitments. If these commitments made it impossible to declare a dividend, so to do would be an abuse of their powers. The Holding Company had no specific claim by way of dividend or otherwise on the specific funds or on any other fund of the subsidiaries. Its powers were those of a shareholder. Even if we were to accept - which is not the case - the wider principle formulated by Lord Denning, it would again be impossible to lift the veil of incorporation in this case unless we did away with the principle in *Salomon*. I discern no intrinsic injustice in sustaining the separateness of the companies as the law requires.

The submissions relevant to double taxation have no validity. What was taxed was the income of the Holdings in 1978. That the dividend derived from the income of a subsidiary, that could

not have been subjected to special contribution at the time of its earning is, in my view, totally irrelevant. There is no rule that the distribution of the income of a subsidiary after tax is not liable to the tax legislation at a subsequent time if distributed as dividend.

In my judgment, the applicants failed to satisfy me that the sub judice decision is in any way wrong or that it was not open to the respondents to arrive at such a decision.

The recourse is dismissed. Let there be no order as to costs.

Recourse dismissed with no order as to costs.