

1986 January 25

[STYLIANIDES, J.]

IN THE MATTER OF ARTICLE 146
OF THE CONSTITUTION

T.Z. GUARANTEE DEVELOPMENTS LTD..

Applicants,

v.

THE REPUBLIC OF CYPRUS, THROUGH
THE COMMISSIONER OF INCOME TAX OF
THE MINISTRY OF FINANCE.

Respondents.

(Case No. 664/84).

Income Tax—The Assessment and Collection of Taxes Laws. 1978-79, s. 36(1)—Artificial or fictitious transaction—
The Commissioner of Income Tax has power to reach the
conclusion that not the whole but only a part or some of
5 the conditions or terms of the transaction in question are
artificial or fictitious—The Court will not interfere with
his discretion if the decision he reached was reasonably
open to him.

Company Law—Veil of Incorporation—It can be lifted in
10 *favour of the revenue.*

Administrative Law—Income tax cases—Approach of the
Court not different from its approach in respect of any
other administrative decision liable to review under
Article 146 of the Constitution.

15 The applicants, a company of limited liability incorpo-
rated on 2.8.78 and dealing with land, development of
land etc., purchased from another company a number of
building sites at £6,000 each. On 1.11.80 the applicants
sold one of these building sites to the partnership of
20 “Thrassou Bros. and Associates” for £7,800 payable as

follows, namely £1,000 not later than 31.12.80, £3,400 in 1983 and £3,400 in 1982.

The shareholders of the applicant company at the material time were Charis Thrassou 3,000 shares and Michalakis Thrassou £1,000 shares. Charis Thrassou is the main partner in the firm "Thrassou Bros. and Associates," i.e. the purchasers of the said site. At the time of the said contract of sale the applicants owed to the said partnership an amount of £4,800 for architectural services earlier rendered. This amount was neither set off nor accounted for against the sale price of the said site. Only in the applicants objection dated 16.3.84 it is noted that this sum would be paid in 1984.

In the applicants audited accounts for the year 1980 it is recorded that they earned £231.- in 1980 from the sale of the said site, i.e. the proportion of the £1,000 cash received in 1980 against the sale price. The respondent Commissioner, however, reached the decision that the whole profit from the said sale i.e. £1,800, was earned in 1980. On 16.3.84 the applicants objected to the said decision. The Commissioner did not accept the objection and as a result took the sub judice decision.

Held, dismissing the recourse (1) The principle of separateness of corporation is well rooted in the Company Law ever since *Salomon v. Salomon*, *infra*. But there are exceptions to the rule. The veil of incorporation is lifted in the revenue's favour.

(2) The crucial question is whether in this case the Commissioner exercised in a proper manner his powers under s.36(1) of the Assessment of Collection of Taxes Laws, 1978-1979.*

"Artificial" and "fictitious" have no definition but hardly anyone is needed. It is for the respondent to determine from his findings of primary facts the further fact whether there was an act which was not real, an act without any commercial or business purpose apart from a tax advantage.

* s. 36(1) is quoted at p. 386 post.

5 The respondent under s.36(1) is empowered to come to the opinion that not the whole transaction but a part or conditions or terms of the transaction are artificial or fictitious. It is not necessary for the transaction to be unlawful or illegal. It is sufficient if it was entered into or done only for the purpose of evading the payment of income tax.

10 The power of this Court is limited to the scrutiny of the legality of the action, and to ascertain whether the Administration has exceeded the outer limits of its powers. Provided they confined their action within the ambit of their power, an organ of public administration remains the arbiter of the decision necessary to give effect to the law; and so long as they make a correct assessment of
15 the actual background and act in accordance with the notions of sound administration, their decision will not be faulted. In the end the Courts must sustain their decision if it was reasonably open to them.

20 (3) In this case there was material upon which the respondent could properly reach the conclusion that the mode of payment was artificial and fictitious. The sub-judice decision was reasonably open to him.

Recourse dismissed.
No order as to costs.

25 Cases referred to:

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

The Bank of Cyprus (Holdings) Ltd. v. The Republic
(1985) 3 C.L.R. 1883;

Howker v. Compton, 8 Tax Cases 306;

30 *Kingsfield v. Republic* (1966) 3 C.L.R. 45;

Coussoumides v. The Republic (1966) 3 C.L.R. 1;

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

Mangli v The Republic (1983) 3 C.L.R. 52;

Recourse.

Recourse against the decision of the respondents whereby they assessed in the year of assessment 1980 the whole amount of profit realized by applicants from the sale of a building site at Archangelos locality. 5

M Christodoulou, for the applicants.

M. Photiou, for the respondents.

Cur. adv. vult. 10

STYLIANIDES J. read the following judgment. By this recourse the applicants challenge the validity of the decision of the respondent in assessing in the year of assessment 1980 the whole of the profits realized from the sale of a building site at Archangelos locality, communicated to them by letter of 25.9.84. 15

The applicant company was incorporated on 2.8.78 as a private company of limited liability. The issued and fully paid up share capital was 4,000 shares of £1.- each. The company is dealing with land, immovables, development of land, etc. The applicants purchased building sites from Ayios Andronicos Developments Ltd. at £6,000.- each. The purchase price was payable by instalments. 20

On 1.11.80 one of those building sites was sold by the applicants to the partnership "Thrassou Bros Associates" for £7,800.- The terms of payment, as appearing in a contract of sale entered into between the vendor and the purchaser, were as follows:- 25

- (a) Not later than 31.12.80 £1,000.-
- (b) In 1983 £3,400.- 30
- (c) In 1984 £3,400.-

In February, 1982, the applicant company submitted its audited accounts for the year 1980, as prepared by its accountants. In the said accounts it is recorded that the

applicants earned £231.- in 1980 from the sale of the building site, i.e. the proportion of £1,000.- cash received in 1980 against the sale price.

5 The respondent Commissioner taking into consideration all the material facts pertaining to the relationship of the parties in this transaction, reached the decision that the whole of the profit of £1,800.- realized from the sale of this building site was earned in 1980 and should have been brought in the Profit and Loss Account for that year and
10 he communicated his such decision to the applicants by letter of 13.2.84.

The applicants disputed this assessment and by notice objected in writing thereto. As no agreement was reached, the respondent Commissioner proceeded to the determination of the amount of the object of the tax, took the
15 challenged decision and notified the applicants accordingly. The decision and notice of assessment were sent to the applicants on 25.9.84. Hence this recourse which is governed by the same principles as any other recourse under
20 Article 146 of the Constitution.

The basic facts on which the Commissioner relied are uncontested and briefly are as follows:-

The shareholders of the applicant company at the material time—indeed from 1.5.79 to date—are Charis Thrassou
25 3,000 shares and Michalakis Thrassou 1,000 shares. Charis Thrassou is the main partner in the firm “Thrassou Bros & Associates,” the purchasers of the building site in question.

The applicant company owed to the purchaser firm of
30 “Thrassou Bros & Associates” at the time of the contract of sale of the building site £4,800.- in respect of architectural services rendered by the said firm to the applicants earlier. This amount was neither set off nor accounted for against the sale price of the said building site nor was it
35 paid off. Only in the objection of 16th March, 1984, raised to the assessment (see exhibit No. 2) it is noted that these fees would be collected in 1984, though the stipulated price of the building site was paid off in 1983.

Counsel for the applicants argued that income tax is payable for each year of assessment upon the income of any person accruing in the year of assessment; that the applicant company is a separate legal entity from its shareholders and the purchasers. The veil of incorporation cannot be lifted and the decision of the respondent is unreasonable and contrary to the Law as the applicants collected only £1,000.- and no more according to the contract. 5

Counsel for the respondent, on the other hand, in support of the sub-judice decision submitted that "the whole profit from the sale of the building site is taxable in the year of sale as there is a close relationship between the vendors and the purchasers, the purchasers being the shareholders of the vendor company, and the alleged terms of payment in the sale agreement are not deemed to have any good commercial character judged by objective criteria. The mode of payment and not the whole sale transaction was properly considered by the respondent as artificial or fictitious for the purpose of reducing the object of the tax of the applicants and, therefore, was properly disregarded. 15 20

This case turns on the crucial question of whether the Commissioner properly exercised the powers vested in him by s. 36.

Section 36(1) of the Assessment and Collection of Taxes Laws, 1978-1979 reads:- 25

«36.- (1) Οσάκις ο Διευθυντής κρίνη ότι αναφορικώς προς φορολογικόν τι έτος το αντικείμενον φόρου οιαυδήποτε προσώπου μειούται εκ πράξεων αίτινες, κατά την γνώμην αυτού, δεν είναι γνήσiai ή είναι ει- κονικαί, δύναται να αγνοήση οιαυδήποτε τοιαύτην πράξιν και να φορολογήση τα ενδιαφερόμενα πρόσωπα επί του ορθού αντικειμένου φόρου». 30

("Where the Director is of the opinion that in respect of any year of assessment the object of the tax of any person is reduced by any transaction which in his opinion was artificial or fictitious, he may disregard any such transaction and assess the persons concerned on the proper object of the tax"). 35

"Artificial" and "fictitious" have no definition but

hardly anyone is needed. It is for the respondent to determine from his findings of primary fact the further fact whether there was an act which was not real, an act without any commercial or business purpose apart from a tax advantage.

The primary facts in this case are not in dispute. It is, therefore, upon the Commissioner to draw the inferences from the primary facts.

The principle of separateness of corporation is well rooted in the Company Law ever since *Salomon v. Salomon*, [1897] A. C. 22, as a company has a personality separate and independent from that of its shareholders. The inroads to the corporate principle by jurisprudence and statute are very few. Nevertheless, in a proper case there may be exceptions to the rule—*The Bank of Cyprus (Holdings) Ltd. v. The Republic of Cyprus, through the Commissioner of Income Tax*, Revisional Appeal No. 317.*

The veil of incorporation is lifted in the revenue's favour—(See *Gower's Principles of Modern Company Law*, 4th Edition, p. 121). In this case only the curtain was slightly raised and the shareholders protruded as no others but the partners of the purchaser firm. The raising of the curtain in this particular case is permissible for the purpose of preventing tax avoidance.

The respondent under s. 36(1) is empowered to come to the opinion that not the whole transaction but a part or conditions or terms of the transaction are artificial or fictitious. It is not necessary for the transaction to be unlawful or illegal. It is sufficient if it was entered into or done only for the purpose of evading the payment of income tax.

In *Hawker v. Compton*, 8 Tax Cases 306, a case in which the question in issue was whether the appellant was the sole occupier of a certain farm or whether he occupied it jointly with his three sons and daughter, the appellant had been assessed for the purposes of income tax on the basis that he was the sole occupier of the farm, though a

* Reported in (1985) 3 C.L.R. 1883.

written agreement was produced purporting to be an agreement of partnership in the farming business between the appellant and his three sons and daughter. The Commissioners came to the conclusion that the appellant was the occupier of the farm and that the assessment was correctly raised in his name and that there had been no partnership in fact during the year in question and, further, that the terms of the deed were not consistent with the existence of an actual partnership. Sankey, J., put the question as follows:-

“The Commissioners having heard the contentions were of opinion that Håwker was the occupier of the farm and the assessment was correctly raised in his name. That may be a question of fact. If there was no evidence upon which the Commissioners could have come to that conclusion there would have been a question of law, but, if there was evidence upon which they came to that conclusion, I do not think that I could disturb it”.

And further down:-

“I put my judgment upon the ground that they heard his evidence; it was a question of fact for them, and there was material upon which they could come to the conclusion which they arrived at.”

In *Kurt Kingsfield v. The Republic of Cyprus, through the Minister of Finance*, (1966) 3 C.L.R. 45, the Commissioner was of opinion that a part of the partnership agreement which provided for the payment to the appellant's daughter of 13% of the share of the profits of the partnership business was artificial and fictitious. The Court came to the opinion that there was material upon which the Commissioner could properly come to the conclusion that that part was artificial and fictitious in the sense of the then s. 56(1) of Law No. 58/61 (identical to s. 36(1) of the Law in operation now), and subsequently to disregard it for the purpose of assessing the tax of the applicant.

The question that has to be answered is the following: Was it reasonably open to the Commissioner to reach its decision on the material before him?

The respondent Commissioner properly took into account the following factors:-

- 5 (a) The only shareholders of the applicants were Charis Thrassou and Michalakis Thrassou. The shareholder-Director of the company, Charis Thrassou, is the main partner in the partnership "Thrassou Bros & Associates";
- 10 (b) At the time of the contract of sale the vendor company was indebted to the purchaser partnership for £4,800 - for architectural fees but this amount was neither set off nor accounted for in this sale transaction and it was "still due and payable" some years later;
- 15 (c) The sale price was declared to have been agreed to be payable £3,400.- in 1983 and £3,400 - in 1984.

20 The approach of the Court in tax cases is no different to any other administrative decision liable to review under Article 146. The initial burden of proof to satisfy the Court that it should interfere with the subject-matter of a recourse lies on the applicant-(*Coussoumides v. Republic*, (1966) 3 C.L.R. 1; *Georghiades v. Republic*, (1982) 3 C.L.R. 659, *Mangli v Republic*, (1983) 3 C.L.R. 52; s.21(1) of the Assessment and Collection of Taxes legislation)

25 The power of this Court is limited to the scrutiny of the legality of the action, and to ascertain whether the Administration has exceeded the outer limits of its powers. Provided they confine their action within the ambit of their power, an organ of public administration remains the

30 arbiter of the decision necessary to give effect to the law, and so long as they make a correct assessment of the actual background and act in accordance with the notions of sound administration, their decision will not be faulted. In the end, the Courts must sustain their decision if it was

35 reasonably open to them - (*Hadji-Eraclis and Another v. Republic*, (1984) 3 C.L.R. 604).

I am of the opinion that there was material upon which the Commissioner could properly reach the conclusion

that the mode of payment was artificial and fictitious and to disregard it; the sub judice decision was reasonably open to him and the assessment which is the subject-matter of this recourse was lawfully and properly made by the Commissioner in exercise of the statutory powers vested in him. 5

For all the above reasons this recourse fails and is hereby dismissed. Let there be no order as to costs.

Recourse dismissed.
No order as to costs. 10