

1987 December 30

[A LOIZOU J]

IN THE MATTER OF ARTICLE 146 OF THE CONSTITUTION
CHRISTODOULOS LEONIDA

Applicant,

v

THE REPUBLIC OF CYPRUS, THROUGH
THE MINISTRY OF FINANCE AND/OR
THE DIRECTOR OF INCOME TAX,

Respondents

(Case No 978/85)

Contract — Assignment — Agreement without consideration for the assignment of interest due to applicant by company A to company B (applicant's family company) — Company A not a party to such agreement — Agreement void

Taxation — Income tax — Agreement to assign applicant's income, i.e. interest due to him by company A, to company B — The mortgage securing the capital of the debt and the interest payable thereon remained in the name of the applicant — Whether interest could continue to be charged on applicant's chargeable income — Test applicable — In the circumstances of this case the question was answered in the affirmative

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The present recourse is directed against the income tax assessments for the years of assessment 1979 to 1982 (years of income 1979 to 1982 both inclusive) The recourse, affects it seems, also the special contribution assessments relating to the four quarters of each of the year ended 31st December, 1979, 31st December 1980, and 31st December, 1981

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The question that has to be decided in this case is whether the interest, which was due to the applicant by Armonia Estates Ltd, under a mortgage agreement, could be charged, as it was in fact charged by the sub judice decisions, to applicant's chargeable income, notwithstanding that under an «agreement dated 3.1.80» such interest was in fact collected by Andros and Brothers Hotel Apartments Co Ltd, which is a private family company of the applicant, his wife and children

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The said agreement of 3.1.80 appears in the minutes of «Andros and Brothers Hotel Apartments Co Ltd» The material part reads as follows «Christodoulos Leonida offered to assign to the company the whole amount

he has to receive from ARMONIA ESTATES Ltd The meeting accepted the offer of Christodoulos Leonida and decides that (b) Any amount of interest of the debt of ARMONIA ESTATES be deemed as income of the company *

5 It must be noted that Armonia Estates Ltd was not a party to the agreement and that the mortgage remained in the name of the applicant until the final discharge of the debt

10 Held, *dismissing the recourse* (1) The agreement of the 3rd January 1980 is in effect an undertaking or arrangement made between the applicant and his company Andros Brothers Hotel Apartments Co Ltd for no consideration Armonia Estates Ltd was not a party to it Hence it could not be binding in law

15 (2) Assuming that the said agreement was valid, the question is whether it constitutes an effective disposition or alienation or absolute assignment of income, or merely to a charge or application of income In the first case the income cannot be charged to applicant's chargeable income, whilst in the second case it should be so charged (*Kitromelides v The Republic* (1973) 3 C L R 123, *Perkins' Executors v The Commissioner of Inland Revenue*, 13 T C 851 and *Chans Georghallides*, 23 C L R 249 cited with approval)

20 (3) Under the arrangement of 3 1 80 the property in the interest did not pass to the applicant's private family company, the mortgage in question continued to be in the applicant's favour until its final settlement in 1982, and he had exclusive right to the interest accruing from the debt due to him by Armonia Estates Ltd, the latter being answerable in law only to him for the payment of such interest

25 *Recourse dismissed*
No order as to costs

Cases referred to

Kitromelides v The Republic (1973) 3 C L R 123.

Perkins' Executors v The Commissioner of Inland Revenue, 13 T C 851,

Georghallides, 23 C L R 249

30 Recourse.

Recourse against the income tax assessments raised on applicant for the years of assessment 1979-1982.

A. Magos, for the applicant.

Y. Lazarou, for the respondents.

35 *Cur. adv. vult.*

A. LOIZOU J. read the following judgment. The present recourse is directed against the income tax assessments for the years of assessment 1979 to 1982 (year of income 1979 to 1982 both inclusive) details of which appear in the Schedule to the opposition, (Appendix «A»). The recourse, affects it seems, also the special contribution assessments relating to the four quarters of each of the years ended 31st December 1979, 31st December 1980, and 31st December, 1981, as shown in Appendix «B», though no specific mention is made in it. 5

The applicant derived at the material time his income from emoluments as an employee of the Electricity Authority of Cyprus up to the 31st October 1981 and from the 1st August 1981 as a director of his private family company Andros Brothers Hotel Apartments Co. Ltd., of Paphos; moreover he derived income from interest from Armonia Estates Ltd., of Paphos and also received bank interest. 10 15

He submitted his return of income for the year 1979 on the 21st April, 1980 and declared as income only his salary from the Electricity Authority amounting to £3847. He was assessed on the 23rd August 1980 only on this salary but he objected against the assessment on the 2nd September 1980, claiming relief for a disabled child. His return of income for the year 1980 was submitted on the 11th June 1981, and again he declared as only income his salary of £4691 from the Electricity Authority. He was assessed on the 19th October 1982, but the respondent Commissioner added to this salary an amount of £5000 as earned interest. The applicant objected against this assessment, (Appendix «C»). Claiming that he did not have any income from interest and stating that the interest from Armonia Estates Ltd., belonged to Andros and Brothers Hotel Apartments Ltd., by assignment (Appendix «D»). As no return of income was submitted by the applicant for the year 1981, the respondent Commissioner assessed him on the 19th October 1982 on the basis of available information. An objection against this assessment was submitted (Appendices «C» and «D»). On the 18th May, 1983, the applicant was requested to submit his return of income for the year 1981 which he did on the 27th May, 1983 declaring only his salaries from the Electricity Authority and his company. On the 25th May, 1983 he was served with a notice to pay the tax in dispute amounting to £206.65 which he did. 20 25 30 35 40

The applicant's return of income for the year 1982 was submitted on the 28th April 1983 and he declared again that his only income was derived from the family company. On the 25th May 1983, he was assessed for 1982 by adding to this income an amount of £12,489 by way of interest. An objection against this assessment was made on the 28th June 1983, on the ground that his income was lower than that assessed. On the 10th June 1983, the respondent Commissioner addressed a letter to the applicant requesting him to submit the following information for settlement of his income tax liability (Appendix «E»).

«(i) A capital statement showing his own, his wife's and his dependent children's assets and liabilities as at 31st December 1982.

«(ii) Certificate from Armonia Estates Ltd giving details of his account with that company, including the amounts of interest paid or credited to him on the balance due to him from the sale of certain immovable property.

«(iii) Copies of the vending agreement regarding the sale of certain properties including any supplementary contracts varying the original vending agreements.

«(iv) Copy of the Bond and/or Mortgage agreement that has been effected for the settlement of the debt due to him from the sale of his properties.

«(v) Copy of his and his wife's bank accounts for 1979 and 1980.

«(vi) Certain other particulars.»

On the 9th July 1983, the applicant submitted through his accountant Mr. George Avraamides the particulars requested including a number of documents, copies of which have been produced as Appendices «F» to «J».

The respondent Commissioner after considering the particulars and evidence submitted, including the accounts of Andros and Brothers Hotels Apartments Ltd., decided that the interest paid by Armonia Estates Ltd., relating to the acquisition of the applicant's properties covered by the agreements earlier referred to could not be considered as income of the company as declared in the accounts for the years 1980 onwards but that the relevant interest (see paragraph 9, of the opposition), legally formed part of the income of the applicant on the following grounds:

(a) The interest was payable to the applicant himself as provided by the contracts of sale and the mortgage loan signed between himself and Armonia Estates Ltd.

(b) The minutes of the board of directors of Andros and Brothers Hotel Apartments Co. Ltd. dated the 3rd January 1980, had no legal effect as a deed of assignment of the rights of the applicant arising out of the specific vending agreements and/or mortgage loans existing with Armonia Estates Ltd. and did not bind Armonia Estates Ltd. since the debtor company (Armonia Estates Ltd.) was not a party to any legal deed of assignment. 5 10

(c) There was no official transfer of the mortgage loan in favour of Andros and Brothers Hotel Apartments Co. Ltd. The relevant mortgage which was registered in the books of the Paphos Land Registry Office under No. 943/79 on 13th 15 October, 1979, was and remained in favour of the applicant until its final settlement in 1982.

The respondent Commissioner revised the Income Tax Computation submitted with the accounts of Andros and Brothers Hotel Apartments Co Ltd., and deducted therefrom the interest included as received from Armonia Estates Ltd. The revision with copy to the company was notified to the company's accountant by letter dated 7th September 1985 (Appendix «K»). 20

The amounts of interest involved are the following:

Year 1980: Bank interest	£483	25
Year 1981: Interest from Armonia Estates Ltd.	£10,025	
Year 1982: Interest from Armonia Estates Ltd.	<u>£12,439</u>	
Total income deducted from company's computations:	<u>£22,947</u>	

The respondent Commissioner explained to the applicant and his accountant at the various meetings which took place at the Income Tax Office Paphos the reasons for which he decided to assess the applicant with the interest paid by Armonia Estates Ltd. but no agreement could be reached on this point. The applicant's objections against the income tax assessments for the years 1979 30 to 1982 were determined by the respondent who communicated 35 his decision to him on the 7th September 1985 together with the relevant Notices of Assessment. (Appendices «L», «O»).

The amounts of interest as finally assessed on the applicant are based on a certificate dated the 10th July 1985, obtained by the respondent Commissioner from Armonia Estates Ltd., (Appendices «P», «Q» and «R»). They are as follows:

5	Contract	A	B	C	Total
	Year 1979	£5,500	£192	-	£5,692
	» 1980	3,682	7,720	£2,012	13,384
	» 1981	3,287	2,113	2,100	7,500
	» 1982	-	-	1,730	1,730
10		<u>£12,439</u>	<u>£10,025</u>	<u>£5,842</u>	<u>£28,306</u>

In the notice of opposition there are set out the relevant Laws and section thereof under which the assessments in question were raised and I need not reproduce them here as the question which has to be decided is whether the interest which was due to the applicant from Armonia Estates Ltd., under the mortgage agreement which was collected instead by Andros and Brothers Hotel Apartments Co. Ltd., by virtue of the agreement of the 3rd January, 1980, (Appendix D), should be charged to the applicant's chargeable income.

20 It is therefore necessary to examine the legal effect of the agreement of the 3rd January but before doing so, the full text of the document in question which has to be set out herein:

25 «MINUTES OF THE MEETING OF THE COMPANY
ANDROS AND BROTHERS HOTEL APARTMENTS
LIMITED
DATED THE 3rd JANUARY 1980

PRESENT: Christodoulos Leonida,
Demetra Chr. Leonida,
Andreas Christodoulou, and
30 Liza Christodoulou

SUBJECT: Assignment to the Company by Christodoulos Leonida of his rights on a debt of ARMONIA ESTATES Ltd., to him.

WHEREAS Christodoulos Leonida one of the shareholders has to receive a substantial amount from ARMONIA ESTATES Ltd., and

WHEREAS the Company is in need of financial resources for its building works, BY THIS, Christodoulos Leonida offered to assign to the Company the whole amount he has to receive from ARMONIA ESTATES Ltd.

The meeting accepted the offer of Christodoulos Leonida and decides that:

(a) Any receipt from ARMONIA ESTATES be deposited in the name of the company with the Bank of Cyprus.

(b) Any amount of interest of the debt of ARMONIA ESTATES be deemed as income of the Company, and

(c) Every so collected sum be kept in a separate account and a decision be taken at a new meeting as to its transfer to its Share Capital or otherwise.

Paphos 3/1/1980

(Sgd.) By the four persons present. •

It is the case for the applicant that the aforesaid described as the written agreement dated the 3rd January, 1980 is, in all respects legal and that the stand of the respondent Commissioner to be found in paragraph 9 a, b, and c, of the Opposition reproduced hereinabove as paragraphs (a), (b) and (c) as notified to the applicant by his letter dated the 7th February, (Appendix K) is not warranted by the Law.

The said agreement was made by the applicant who assigned thereby his rights from the written agreements of the 15th January, 1980, (Appendix 5 and 6) to his wife and his children gratis for the establishment of Andros and Brothers Hotel Apartments Co. Limited which was not at the time registered in accordance with the Law. Furthermore the allegation contained in paragraph (b) cannot stand as Armonia Estates Limited was not made a contracting party to the agreement of the 3rd January 1980. More so, as the Contract Law Cap. 149 clearly defines when a contract is valid or void, and the agreement in question is in all respects valid.

Furthermore, the contents of paragraph (c) above cannot support the view that the said agreement is not valid if the mortgage under No. 943/79, dated 13th October 1979, in the name of the applicant still remained in force as that is a different
5 matter from the validity of the agreement

The points raised are not devoid of authority. In the case of *Kitromelides v The Republic* (1973) 3 C L R 123 p 134, Hadjianastassiou, J, had this to say

10 «The way a person chooses to spend or apply his income is not material for income tax purposes, even if such expenditure is necessitated by law or by a contract and no deduction is allowable either for the purpose of assessment or for the purpose of computing total income from all sources in respect of any such application »

15 The same view was expressed in *Perkins Executors v The Commissioner of Inland Revenue*, 14 T C 851 by Rowlatt J -

20 «It seems to me that the question - I think the Solicitor - General agreed with me - as a question can be stated very clearly. If a person has alienated his income so that it is no longer his income he is not supertaxed upon it, but if he merely applies the income so that it passes through him and goes on to an ulterior purpose, even although he may be obliged to do so, still that remains his income »

25 The principle laid down in *Perkins* case was adopted and followed in the case of *Chans Georghallides*, 23 C L R 249, where as regards the issue as to whether the transaction in that case amounted under the then in force Income Tax Law, Cap 297, to an effective disposition or alienation, or absolute assignment of income, or merely to a charge or application of income, Zekia J
30 said at p 257 -

35 «The transaction in question amounts to nothing else than to an undertaking by the son to pay to his mother the portion of rent collected by the former according to the terms of the contract. The creation of a charge on this particular income of the appellant has been intended. There is no privity of contract between the tenants and the mother. There is no absolute assignment of future rents or part thereof. Does this agreement have the effect of an effective disposition of part of the income of the appellant so as to entitle him not to include

this sum in his chargeable income or, in the alternative, does it entitle him to a claim of a deduction for an equivalent amount from his income?

We have to fall back to the general law and find out whether the purported transfer of income is effective enough to pass property in the income to the donee, i.e. covenantee or trustee. In other words, there must be an alienation of income so that the seller or covenantor might say that a particular income is no more his. A disposition short of an alienation in our view is not sufficient for shifting the liability to pay tax on somebody else. A disposition for instance which only creates a charge on a particular income or in effect does not go beyond a contractual obligation on the part of a promisor to hand over part of the income he collects from a definite source could not be considered an effective disposition or alienation of income for the purpose of the Income Tax Law. This view derives some support by the following provisions akin to section 50(3) of Income Tax Law (Sections 392, 393, 395 and 397 of the Income Tax Act, 1952). They relate to dispositions made by the donor, the owner of income, in favour of his minor children and disposition in favour of persons generally, for periods which cannot exceed six years »

The agreement of the 3rd January 1980 is in effect an undertaking or arrangement made in the present case between the applicant and his company Andros Brothers Hotel Apartments Co Ltd, for no consideration and with Armonia Estates Ltd, not a party to it, hence it could not be binding in law. Assuming however, the said arrangement to be binding as between the applicant and his company the interest in question should nevertheless be charged to his chargeable income because under such arrangement the property in the interest did not pass to the applicant's private family company the mortgage in question continued to be in the applicant's favour until its final settlement in 1982, and he had exclusive right to the interest accruing from the debt due to him by Armonia Estates Ltd, the latter being answerable in law only to him for the payment of such interest

In fact and in law the arrangement was not an effective disposition or alienation or absolute assignment for income tax purposes as it did not go beyond the maximum of a contractual obligation on the part of the applicant to hand over to his family Company the interest to which he was entitled. The applicant

cannot say that the interest in question is no longer his, as the purported transfer of the income was not effective enough to pass properly in the income to the disponent, nor did it transfer to the family Company a legal or equitable interest or share in the income derived from the mortgage. Therefore, the Commissioner rightly charged this sum to the applicant's chargeable income.

The position being so, I need not proceed to expound the position of assignment at Common Law and Equity in Cyprus.

For all the above reasons the Commissioner's decision was reasonably open to him and correct in law and therefore, the recourse should be and is hereby dismissed, and the sub judice decision confirmed in whole under Article 146(4)(a) of the Constitution. In the circumstances however, there will be no order as to costs.

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*Recourse dismissed.
No order as to costs.*