

1988 December 23

[SAVVIDES, J.]

IN THE MATTER OF ARTICLE 146 OF THE CONSTITUTION

PHANOS G. IONIDES,

Applicant,

v.

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

Respondent.

(Case No. 62/82).

Taxation—Income tax—What is income.

Taxation—Special contribution—Whether taxpayer may apply the "cash basis" method as regard his income tax assessment and, at the same time the "earning basis" method as regards special contribution—Reasonably open to the respondent to adopt, contrary to the taxpayer's wishes, the "cash basis" method for special contribution purposes, i.e. the method, which the taxpayer chose to use for income tax purposes.

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Taxation—Income tax—Deductible expenses—The Income Tax Laws, 1962—1981, sections 13(e) and (f)—But for section 8 of the Special Contribution (Temporary Provisions) Law, 1978 (Law 34/78), special contribution would not have been a deductible expense—Now that it is deductible, it must be deducted together with all other deductible expenses—The "earned income relief" is applicable on the amount left after such deductions.

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Taxation—Assessment—Income tax and special contribution—The two methods that may be used in computing the income liable to the tax—What is the "cash basis" method and what the "earning basis" method.

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The first question which arises is whether income earned prior to 1st October, 1974, but actually received after that date, is liable to special contribution.

5 As regards this question it must be noted that the applicant had elected to follow for income tax purposes—as indeed he was entitled to do, the "cash basis", as opposed the "earning basis" method of computing his income. Such election was made before the enactment of the legislation concerning special contribution.

The essential difference between the two methods is that under the "earning basis" method revenue is chargeable to tax in the period that it becomes due whereas under the "cash basis" method it is chargeable on the date it is actually received.

10 The second question which poses for consideration is whether in assessing his income liable to income tax earned income relief should be allowed on the applicant's income before deducting therefrom the special contribution payable. The amount of special contribution is a deductible expense in virtue of the Special Contribution (Temporary Provisions) Law 15 1978 (Law 34/78).

20 Held, dismissing the recourse: (1) In effect the applicant's position is that he is entitled to follow the "cash basis" system which he himself elected for income tax purposes as the method to follow for income tax assessments and the "earning basis" method for special contribution purposes. By using the one method for one purpose and the other method for another purpose he is trying to get the benefit of both methods. The respondents decision to consider such a choice as unacceptable and that the method to be followed for special contribution purposes should be the the same as that followed in respect of income tax was reasonably open to him.

25 (2) The word "income" however, is not defined in the Income Tax Laws. However, according to the principles of commercial accountancy the income of a business is the surplus of receipts over outgoings and expenses incurred by the business. In the light of sections 13(e) and 13(j) of the Income Tax Laws 1961-1981 the special contribution being essentially a tax 30 will not be an allowable deduction. Section 8, however, of Law 34/78 treats the special contribution payable as a deductible expense.

Since the special contribution payable is treated under the law as an expense it falls to be deducted with all other outgoings and expenses from the receipts of the business before earned income relief is given.

35 *Recourse dismissed.*
No order as to costs.

Cases referred to:

I.R.C. v. Morrison [1932] 17 T.C. 325;

Minerva Cinetheatrical Co. Ltd. v. The Republic (1975) 3 C.L.R. 116;

Courtis Enterprises Ltd. v. The Republic (1988) 3 C.L.R. 2209.

Recourse.

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Recourse against the assessments raised on applicant for special contribution levied on his income for the quarters ending in the years 1975 and 1976 and also the assessments for income tax for years 1976 and 1977 (years of income 1975 and 1976).

Chr. Triantafyllides, for the applicant.

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

Cur. adv. vult.

SAVVIDES J. read the following judgment. Applicant by this recourse challenges the assessments for special contribution levied on his income for the quarters ending in the years 1975 and 1976 and also the assessments for income tax for the years of assessment 1976, 1977 (years of income 1975 and 1976) which were raised and determined by the respondent Commissioner of Income Tax as per notices of assessment communicated to the applicant.

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The applicant derives his income from his practice as Tax Consultant, from pensions from the Republic of Cyprus and Social Insurance Fund, from emoluments from the Nicosia Race Club, from interest and rents.

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Applicant upon starting his own practice of Tax Consultancy in February, 1966 adopted the "cash basis" method for comput-

ing the profits or gains from his practice for income tax purposes. Such method is one of the two alternative methods well known in the accounting practice, the one being the "earning basis" method and the other the "cash basis".

5 The "earnings" method is the usual method whereby profits or gains from business are computed for income tax purposes and which produces more accurate results than the "cash" method. According to this method the revenue of the professional businessman is computed at the value of services rendered during the
10 period notwithstanding that at the terminal date amounts are outstanding either in respect of work in progress or unpaid accounts for completed services. According to the "cash basis" method the profits from business are computed on the basis of the excess of the actual cash receipts during the year over the cash outlays and
15 expenses actually disbursed or paid during the year. Thus the main difference between the two modes is that under the "earnings" method uncollected fees are brought into account whereas under the "cash basis" method they are ignored.

20 In his computation for the relevant periods on the "cash" basis for income tax purposes applicant included the Director's fees and/or Secretary's fees when received.

25 Upon the enactment of the Special Contribution (Temporary Provisions) Law, No. 55/74 of 1st November, 1974 levying special contribution on the quarterly income of every person other than emoluments from any office or employment, applicant addressed to the respondent Commissioner a letter dated 12th May, 1975, touching amongst other points the "cash basis" method adopted by him for income tax purposes and Secretary's fees received from companies.

30 The respondent commissioner having considered applicant's representations decided that the applicant should follow the "cash basis" method for special contribution purposes as well and furthermore that Secretary's fees are treated for the purposes of special contribution as Director's fees provided they are considered

as emoluments and taxed (for income tax purposes) on current year basis. The respondent communicated to applicant his decision by letter dated 23rd May, 1975. The contents of such letter read as follows:

"The Special Contribution (Temporary Provisions) Law No. 55/74 5

I refer to your letter dated 12th instant on the above subject and wish to inform you as follows:

(1) Transfer of losses

The transfer of losses of previous quarters to the subsequent quarter is not allowed as in the case of losses for previous years. 10

(2) Adoption of the 'cash basis' method

I agree with you that the object of Law 55/74 is to include in the Special Contribution profits and income from the period as from 1.10.74 till 31.12.75. In the case however of professionals such as, advocates, doctors, etc, you adopt the 'cash basis' method for income tax purposes, then the same method should be followed for purposes of special contribution as well. 15 20

3. Interest collected by members of the Social Insurance Fund

Such income is income subject to the provisions of Law 55/74 and not income or other benefit emanating from the employment of such member. 25

4. Remuneration of Directors of Companies - Law 54/74 Secretary's fees by companies should also be treated on the same tax basis as remuneration of Directors of Companies provided that they were considered as remuneration and were sub-

ject to income tax on the basis of the current year."

Applicant did neither reply to respondent's Commissioner's letter of 23rd May, 1975 nor did he send any computation of income liable to special contribution or accounts and computation of chargeable income for income tax purposes for the respective years in due time. Applicant submitted accounts and computation of chargeable income for income tax purposes in respect of the years 1975 and 1976 in December, 1978. In the meantime applicant as provided by regulations 2 and 3 of the Special Contribution (Temporary Provisions) Regulations, 1975 had submitted quarterly reports for special contribution on various dates for the respective quarters for the year 1975 and 1976 and had paid temporary contribution on the basis of such returns. In accordance with the aforesaid provisions of the regulations the respondent Commissioner had to accept unquestionably the said returns though not supported by any accounts and computations as to the basis on which applicant arrived at the income declared therein, pending the final determination of applicant's income for the years 1975 and 1976 in accordance with the provisions of regulation 4 of the above - mentioned Regulations.

The respondent Commissioner raised assessments for income tax for the years 1976 and 1977 (years of income 1975 and 1976) on the 20th February, 1979 soon after the completion of the examination of the returns of income and accounts submitted by the applicant. Applicant failed to submit together with the aforesaid accounts separate computations of income liable to special contribution. Hence as provided under regulation 4 of the Special Contributions (Temporary Provisions) Regulations 1975, and upon the basis of the letter dated 23rd May, 1975 the respondent Commissioner computed the special contribution payable by applicant for the quarters ending for the years 1975 and 1976. The special contribution so computed amounted to £1,560 for 1975 and £1,574 for 1976 which being an allowable deduction for income tax purposes were shown as a deduction from the income tax assessments respectively.

The applicant objected against the above assessments by letters dated the 26th February, 1979, exhibits 5 and 6, and 10th April, 1979, exhibit 9. I find it necessary to make reference to the contents of such letters as in fact they form the basis of the written address of counsel for applicant in support of applicant's objection. 5

The letter dated 26th February, 1979, exhibit 5, reads as follows:

"I refer to the Notice of Assessment dated 20.2.79 issued in respect of my income for the year of assessment 1977(76), and would inform you that I object to the said assessment on the following grounds: 10

(a) I have not been allowed £225 reduction in respect of interest from Government Bonds.

(b) The special contribution deducted is unduly high as not all my professional income for 1976, which is returned for income tax purposes on the cash basis, is liable to special contribution for the reason that collections for work done before 1.10.74 paid to me during 1976 should be excluded from assessment to special contribution. No explanation was given as to how it was computed at £1574. 15 20

(c) The total of my pension should be £2522 not £2502.

(d) The amount of the E.T. Relief should be higher.

(e) The allowance of £532 in respect of life assurance premia and contributions to various funds is wrong as during 1976 I did not pay any life assurance premia." 25

The letter dated 26th February, 1979, exhibit 6, reads as follows:

"I refer to the Notice of Assessment (Code 3) forwarded to

me without any covering letter reasoning your determination of the objection and would invite attention to the following:

- (a) The special contribution deducted for 1975 is much higher than what I have paid.
- 5 (b) The earned income relief allowed to me is lower obviously by reason of an overdeduction of special contribution.
- (c) My chargeable income for the year 1976(75) should be higher.
- 10 (d) The tax paid by me in respect of my liability for the year of assessment 1976 (75) is not £645 but £645 plus £100 paid on 28.12.78 and another £100 paid on 5.2.79.
- (e) The total of my pension should be £2091 not £2219.

- 15 2. With regard to special contribution, I would observe that I have not yet received any notices of assessment. I reserve therefore my right to object when I receive them."

The letter dated 10th April, 1979, exhibit 9, reads as follows:

- 20 "I hereby object to the assessments raised on me for special contribution purposes in respect of my income for the years 1975 and 1976.

2. The objection is based on the following grounds:

- 25 (a) The assessment of special contribution on the total of my income for each year as declared for income tax purposes is erroneous.
- (b) My income for each of the aforesaid years was declared

for income tax purposes on the cash basis as the total of the collections of fees made each year irrespective of the year in which services were rendered or the fees collected accrued to me. However, Section 3 of the Special Contribution (Temporary Provisions) Law, 55 of 1974, makes it abundantly clear that special contribution shall be assessed on the income of any person from any source except emoluments for the quarter beginning 1st October, 1974, and for each subsequent quarter and the quantum of my income to be assessed to special contribution should be the income earned by me from services rendered after 1.10.74 and cannot include receipts realized after 1st October, 1974, but relating to services rendered by me before 1st October, 1974.

(c) The fact that I chose for the sake of simplicity to return for income tax purposes my income on the cash basis does not involve any legal obligation for me to include in my income liable to special contribution fees collected by me after 1.10.74 but actually earned by me before 1st October, 1974. I can quote here a striking instance of this viz, the collection of a sum of £2200 which I received during the quarter from 1.6.75 to 30.9.75 for valuation work done for the Cyprus Mines Corporation in 1973. Certain other big sums payable to me in respect of services rendered years before 1.10.74 but collected through Court proceedings after 1st October, 1974, have similarly been included in my returns for income tax purposes for 1975 and 1976.

(d) Apart from what is stated in para (c), part of my fees represents director's fees or fees for my acting as Secretary of Companies which I have included for income tax purposes in my professional receipts as and when collected. The whole of such fees was exempted from assessment to special contribution being remuneration from employment and as the various sums received were below £500 from each employer, they were not liable to

deduction under the Emoluments (Temporary Reduction) Law, 54 of 1974.

- 5 (e) A citizen has no legal obligation to agree in the matter of his liability to income tax or other tax to adopt the method which is most beneficial to the Revenue but is free to choose the legal method which results in his paying a lower amount of tax, however repugnant this legal right of a citizen may be to the Revenue Authorities. There is ample legal authority on this.
- 10 (f) Investment income abroad cannot be made liable to special contribution without specific provision therefor in the relevant taxation law, and in any case such income earned before 11.7.75 cannot be made liable to special contribution as such inclusion means imposition of tax with retrospective effect contrary to the relevant provisions in the Constitution of the Republic.
- 15

3. For the reasons hereinbefore stated you are kindly requested to reconsider the assessments raised."

20 The respondent Commissioner after carefully considering the contents of the objections contained in the aforesaid letters decided to determine the said assessments raised both for income tax and special contributions purposes with certain adjustments made to rectify certain mistakes in allowances granted to applicant. Such decision was communicated to the applicant by letter dated 25th November, 1981, and the relevant notice of tax payable attached thereto. The contents of such letter are as follows:

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30 "With reference to your letter dated 26.2.79 you are hereby informed that your view in connection with the assessment of special contribution for the years 1975 and 1976 cannot be accepted as you have elected previously the method of assessment of your income on the basis of cash collections and such method should be followed also for the purposes of assessment of special contribution.

I enclose notices of assessment of tax as well as notices of verification of contribution for the years 1975 and 1976.

If you do not agree with my above decision you can file a recourse to the Supreme Court within 75 days from the date of this letter." 5

As a result applicant challenged the above decision by filing this recourse praying for:

1. A declaration to the effect to that the assessments raised by the respondent for levying the special contribution on applicant's income for the years 1975 and 1976 are based on erroneous computations of the income liable to special contribution and are wrong in that: 10

(a) They include income which had been earned by the applicant in respect of services rendered prior to 30th September, 1974, but was actually collected during the years 1975 and 1976; 15

(b) They included income which accrued to the applicant by way of fees in his capacity as Director or Secretary of various companies before the 1st September, 1974 but actually collected in the years 1975 and 1976;

(c) They require payment by the applicant of interest at the rate of 6% on the agreed balance of special contributions; 20

And they are, therefore, null and void and of no effect whatsoever.

2. A declaration to the effect that the assessments raised for income tax purposes on the applicant's income for each of the years 1976 (75) and 1977 (76) have been based on erroneous computation of the chargeable income and are, therefore, null and void and of no effect whatsoever. 25

Lengthy arguments have been advanced by counsel for appli-

cant in support of the objections raised against the assessments to which counsel for the respondent answered by his written address.

5 After prolonged adjournments on the application of the parties in an effort to explore the possibility of a settlement and or of narrowing the issues most of the matters in dispute had been settled as it appears in the written address in reply, of counsel for applicant. According to such address the following had been agreed:

10 (a) The applicant was free to adopt any lawful method of computation of the profits for special contribution purposes and that he was not bound to follow the same method the chose for income tax purposes.

15 (b) The fees received from Directorship and Secretaryship of companies (and inferentially from executorship and as administrator of estates or liquidator of companies) should be treated as "emoluments" for special contribution purposes.

(c) No interest on special contribution. If any was eventually payable it would not be claimed by the revenue.

20 (d) The respondent would grant the applicant income relief on the balance of the net receipts after deduction of special contribution and not on the net profits as the applicant claimed.

25 (e) Though the respondent agreed that special contribution should be levied on profits made after 1st October, 1974, still as the applicant has adopted the "cash basis" method for income tax purposes the repondent was not prepared to exclude from assessment to special contribution fees for services rendered before 1st October, 1974, but collected after that date. This point, therefore, remains in dispute along with the undermentioned:

30 A. Whether special contribution is payable on income earned prior to 1st October, 1974, but collected after 1st October, 1974.

B. Whether earned income relief should be granted on the gross amount of pension from Government and Social Insurance Fund and on the net profits from previous receipts before deduction of any special contribution payable.

When the case was fixed for clarifications counsel for respondent stated that in fact two points remained in issue before the Court, namely, (1) Whether earned income relief should be allowed on the applicant's income before deducting therefrom the special contribution payable; (2) whether the income which the applicant earned prior to the enactment of the Special Contribution Law but collected after the law came in force, is liable to special contribution. 5 10

Judgment was subsequently reserved.

In the course of perusing the contents of the written address of counsel on both sides in which their arguments were advanced and the clarifications made I found it necessary to reopen the case and invite counsel to state: 15

(a) In case the recourse fails what would be the effect of certain admissions made by them.

(b) In the case the recourse succeeds to what extent admissions made by counsel for applicant will affect the prayer sought; 20

(c) Whether in the circumstances there existed any possibility for an undertaking by the respondent to make new assessments bearing in mind admissions already made as to the deductibility of certain items not deducted so that the new assessments will represent the correct situation subject to the right of the applicant to challenge such new assessments. 25

In answer to the questions put and in further clarifications counsel for respondent stated the following:

"As regards point (a) the statements which have been made 30

5 by the applicant in his written address, it is agreed that the applicant was free to adopt any lawful method of computation for special contribution purposes. Once however he follows one method he must stick to it and he cannot change methods whenever it is suitable to do so. The applicant in the present case in effect wants to follow the 'cash basis' in respect of his income after 1974 and the 'earning basis' method in respect of his income prior to 1974. This in my humble submission he cannot do.

10 As regards statement B in his written address in reply, it is agreed that fees received from Directorships and Secretaryships of companies should be treated as emoluments for special contribution purposes. We have accepted his point that they should be treated as emoluments.

15 We also agree in respect of point C that there would be no interest on special contribution; if any was eventually payable it would not be claimed by the revenue. We also agree on point D in his reply. As far as point D is concerned once the applicant has adopted either the cash basis or the earnings basis he must follow it in respect of his receipts. In the present case he has adopted the 'cash basis' for special contribution and income tax purposes. Therefore, the income which was earned prior to 1974 but was collected after that date is taxable."

25 Counsel for applicant stated that he had no further clarifications to make and did not dispute the statements made by counsel for the respondent on the questions raised by the Court.

30 In the light of the statements made by counsel for the applicant in his written address in reply and counsel for respondent in his clarifications concerning the elimination of certain issues I shall proceed to deal with the issues which have been left for consideration by this Court.

The first question which arises is whether income earned prior to 1st October, 1974, but actually received after that date, is liable

to special contribution.

Counsel for the applicant contended that the imposition of special contribution to the income earned by applicant prior to 1st October, 1974, the date when the Special Contribution (Temporary Provisions) Law 1974 (Law 55/74) came into force, but collected after that date is retrospective taxation and, therefore, contrary to Article 24 to the Constitution.

Counsel for the respondent submitted that such contention is untenable in view of the fact that applicant followed the "cash basis" method for computing his profits for income tax purposes and therefore he was bound to follow the same method for special contributions.

The "cash basis" method as already explained is one of two alternative methods used for computing the profits, the other one being the "earnings basis" method. The latter is more frequently used being more accurate. Under this method sums due but not yet paid whether debits or credits are brought into account. The "cash basis" method on the other hand takes into account only sums of money actually spent or received regardless of when they became due. The value of the work in progress is brought into account on an "earning basis" but is ignored on a "cash basis". See *I.R.C.v. Morrison* [1932] 17 T.C.325.

Thus the essential difference between the two methods is that under the "earning basis" method revenue is chargeable to tax in the period that it becomes due whereas under the "cash basis" method it is chargeable on the date it is actually received. It follows, therefore, that a person using the "cash basis" method in computing the profits of his practice for special contribution purposes will be taxed on income received after the 1st October, 1974, though earned prior to that date. It also follows that should the special contribution laws be repealed any income received after that date which was earned previously will escape tax.

It is common ground that a taxpayer in computing his profits

either for income tax purposes or for special contribution purposes has a choice to follow either the "earning basis" method or the "cash basis" method.

5 The applicant in the present case at all material times to the present recourse elected the "cash basis" method for the purpose of computation of his income tax and his tax was assessed as a result of computations made on such basis. When the Special Contribution Law came into force the applicant sought to follow the "cash basis" system which he himself elected for income tax purposes as the method to follow for income tax assessments and 10 the "earning basis" method for special contribution purposes. By using the one method for one purpose and the other method for another purpose he is trying to get the benefit of both methods.

15 The respondent considered such choice as unacceptable and in making his assessments thought fit that once the applicant had adopted and made use of the "cash basis" method for income tax purposes he could not utilize the "earning basis" method for special contribution purposes as such choice of two different methods for similar taxations for the purpose of enjoying the benefits of both of them is contrary to the accounting practice. 20

It is well established that a decision against an income tax assessment cannot be disturbed by this Court if it is a decision which could reasonably and properly in law and fact be reached by the taxing authority. See, inter alia, *Minerva Cinetheatrical Co. Ltd v. The Republic* (1975) 3 C.L.R. 116 and *Courtis Enterprises Ltd. v. The Republic*, (1988) 3 C.L.R. 2209. 25

Bearing in mind the principles governing judicial control of taxation decisions I have come to the conclusion that it was reasonably open to the respondent Commissioner to decide that once the applicant elected the "cash basis" method for income tax purposes he could not adopt the "earning basis" method for special contribution purposes. Therefore, applicant's complaint in this respect fails. 30

The second question which poses for consideration is whether earned income relief should be allowed on the applicant's income before deducting therefrom the special contribution payable. According to the provisions of s.21 of the Income Tax Laws 1961-1981 an individual is entitled to a deduction equal to the 1/10th of his earned income in computing his chargeable income. "Earned income" is defined by s. 2 of the Income Tax Laws as meaning any income derived from any trade, business, profession, vocation, employment, pension or annuity if such pension or annuity is granted on account or in respect of employment.

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The word "income" however, is not defined in the Income Tax Laws. However, according to the principles of commercial accountancy the income of a business is the surplus of receipts over outgoings and expenses incurred by the business. As a general rule amounts payable in respect of tax and other duties are not allowable deductions in computing the income of a business because these payments are made after the profit has been ascertained and as such they are not expenses incurred in producing the income. This rule finds support in the provisions of s. 13(e) and (j) of the Income Tax Laws 1961-1981 which provide as follows:

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"Πρός εξεύρεσιν του φορολογητέου εισοδήματος προσώπου τινός δεν θα εκπίπτωνται τα ακόλουθα -

.....

(ε) πάσα δαπάνη ή έξοδον όπερ δεν αντιπροσωπεύει ποσόν εξ ολοκλήρου και αποκλειστικώς διατεθέν ή δαπανηθέν προς τον σκοπόν κτήσεως του εισοδήματος.

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.....

(κ) παν ποσόν καταβληθέν ή καταβλητέον υπό μορφήν φόρου δυνάμει του παρόντος Νόμου ή υπό μορφήν προσωπικής εισφοράς."

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The translation in English is as follows:

(13. For the purpose of ascertaining the chargeable income of any person no deduction shall be allowed in respect of

.....

5 (e) any disbursements or expenses not being money wholly and exclusively laid out or expended for the purpose of acquiring the income;

(j) any amounts paid or payable in respect of tax under this Law or in respect of personal tax;).

10 Under normal circumstances, therefore, the special contribution being essentially a tax will not be an allowable deduction by virtue of the provisions of s. 13(e) and (j) which are applicable in respect of a special contribution by virtue of s.6 of the Special Contribution (Temporary Provisions) Law, No. 34/78.

15 Section 8, however, of Law 34/78 treats the special contribution payable as a deductible expense by providing that notwithstanding any provision of the Income Tax Laws in force for the time being the contribution payable under this law shall be deducted from the chargeable income of every person. Since the
20 contribution payable is treated under the law as an expense it falls to be deducted with all other outgoings and expenses from the receipts of the business before earned income relief is given.

I agree with the submission of counsel for the respondent that to do otherwise it would mean that the taxpayer will be receiving a double relief on the same item in that contribution being deducted
25 from the chargeable income will also qualify for earned income relief something which is contrary to the intention of the legislature.

In conclusion I find that the decision of the respondent to re-

fuse earned income relief as claimed by the applicant on the amount of any special contributions payable and which under the law are deductible expenses from the income was reasonably open to him.

The above issues were the only issues left for determination by this Court. On all other questions the parties reached an agreement and certain undertakings were taken by the respondent on the basis of such agreement to make the necessary readjustments in respect of matters agreed as entitling the applicant to such readjustments.

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In the result this recourse fails subject to the readjustments agreed upon between the parties. In the circumstances of the case I make no order for costs

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*Recourse dismissed.
No order as to costs.*