[ZEKIA, J. and ZANNETIDES, J.]

In the matter of Section 39 (9) of the Income Tax Law, Cap. 297

and

In the matter of CHARIS GEORGHALLIDES of Limassol

Appellant.

(Case Stated No. 126)

1958
Sept. 24,
Nov. 24

IN THE MATTER OF SEC. 39 (9) OF THE INCOME TAX LAW. CAP. 297 and IN THE MATTER OF CHARIS GEORGHALLIDES.

Income Tax—Purported sale of life interest in future rents—Transaction amounting in effect to a contractual undertaking by the covenantor to pay to the covenantee a portion of income in the way of rents to be derived from premises owned by the former—Whether transaction amounts : (a) to a partnership, or (b) to an effective disposition or alienation or absolute assignment of income or (c) merely to a charge or application of income—Distinction between alienation and application of income—Whether the portion of rents so allocated to the covenantee is part of covenantor's chargeable income—If so, whether it should be deducted from the covenantor's income as an outgoing expense—Income Tax Law, Cap. 297, Sections 10 to 14, Section 50 (5) (a).

Onus—Fiscal legislation—Onus on the Tax Authorities to establish liability to pay tax—Onus on the taxpayer to establish a claim for exemption or deduction allowance.

By an agreement in writing dated the 9th July 1954 entered into between the appellant and his mother, the former purported to sell to the latter a life interest in a part of the income derived in the way of rents from premises owned by him, the consideration being a sum of £9,000 odd which the mother advanced to her son (the appellant) with a view to enable him to build the said premises. The agreement is set out in full in the judgment of the Court. The Income Tax Authorities treated the above agreement as valid and the share of the mother in the rents of the premises was added to the income of her husband as being her income.

On the 16th September 1957, however, the Commissioner of Income Tax, treating the sums payable to the mother as forming part of the appellant's income, raised three additional assessments on him for the sum of £1,008 for each of the years of assessment 1955, 1956 and 1957. The appellant appealed to the District Court of Limassol, claiming : (a) that the said portion of the rents allocated to his mother does not form part of his income: (b) that if it does, then he is entitled

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IN THE MATTER OF SEC. 39 (9) OF THE INCOME TAX LAW. CAP. 297 and IN THE MATTER OF CHARIS GEORGHALLIDES.

to have it deducted from his income as an outgoing expense under Section 10 (1) of the Income Tax Law. The District Court rejected both contentions of the appellant. On the application of the appellant under Section 39 (9) of the Income Tax Law, Cap. 297, the District Court stated a case for the opinion of the Supreme Court, which, affirming the decision of the Lower Court,—

Held: (1) In a disputed case the onus to satisfy the Court as to the liability to pay tax is on the Tax Authorities, whereas the onus to establish a claim for deduction, allowance is on the taxpayer. Having this principle in mind, we are of opinion that the Commissioner of Income Tax discharged the onus which rested on him and that the appellant failed to discharge the burden to establish that he is entitled to the deduction allowance claimed.

(2) The definition of the word "disposition" in Section 50 (5) (a) of the Income Tax Law, Cap. 297, does not help in this case. 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 disponee; in other words, whether there has been in this case an alienation of income so that the seller or covenantor might say that the particular income is no more his. A disposition short of an alienation 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 promissor 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 purposes of Income Tax Law.

Principle laid down in Burlinson v. *Hall*, (1884) 12 Q.B.D. 347 at p. 350, *considered*.

Statement of the law in *Halsbury's, Laws of England*, 3rd ed., Vol. 20 p. 423, *applied*.

Commissioner of Inland Revenue v. *Patterson*, (1924) 9 Tax cases, 163; *Pondichery Railway Co.* v. *The Commissioner of Income Tax, Madras*, (1931) L.R. 58 I.A. 239 per Lord MacMillan (see, *post* pp. 260—261); *Perkin's Executor* v. *England Revenue Commissioners*, (1928) 13 Tax Cases, 851 per Rowlatt, J. at p. 858; *Mersey Docks and Harbour Board* v. *Lucas*, (1883) 2 Tax Cases, 25, *per* Lord Selborne, L.C. and Lord Blackburn at pp. 28, 31 and 33, respectively; *followed*.

(3) From the terms of the contract it is apparent that the transaction in question amounts to nothing else than to an undertaking by the appellant to pay to his mother, according to the terms of the contract, the portion of rent collected by the former. There is no effective disposition or alienation or absolute assignment of future rents or part thereof, or of part of the appellant's income so as to entitle him not to include this sum in his chargeable income. In the result, the transaction amounts to a charge on, or application of, the appellant's particular income defined in the contract by virtue of a contractual

obligation. On the other hand, there is no room in this case for the assumption of a partnership between the appellant and his mother. Consequently, the portion of the rents of the premises in question payable to the mother forms part and parcel of the son's (appellant's) chargeable income.

(4) On the issue whether the portion of the rents payable to the mother—being income of the appellant son—should be deducted from the latter's total income as an outgoing expense within the meaning of Section 10 (1) of the Income Tax Law, Cap. 297 :—

Held : As it has already been said it is up to the appellant to show clearly that he was entitled to such deduction. The appellant failed to do so. The nature of the payment involved is the criterion whether it is of a capital nature or expense envisaged by Section 10 (1) which is deductable for the purpose of ascertaining the chargeable income of the person concerned. In the present case a loan of £9,000 was contracted by the appellant from his mother which was expended for the building of the premises yielding the rents. The appellant undertook the contractual obligation to repay the said sum by allocating part of the rents collected. The debt (*i.e.* the loan) in question will be extinguished by the death of the mother. This looks more or less a capital disbursement, rather than a payment made to meet interest on the money lent by the mother, as it has been suggested on behalf of the appellant. We think, therefore, that the Court below was correct in the conclusion to which it has come.

Tata Hydroelectric Agencies Ltd. v. *The Income Tax Commissioner of Bombay* (1937) A.C. 685; *followed.*

The Inland Revenue Commissioners v. *The personal Representatives of Sir Harry Mallaby Deeley, Bart,* (1938) 4 All E.R. 818, at pp. 826—7, *per Sir W. Greene,* M.R.; *followed.*

Appeal dismissed. Decision of the Lower Court affirmed.

Cases referred to :

Burlinson v *Hall,* (1884) 12 Q.B.D. 347.

Commissioner of Inland Revenue v. *Patterson,* (1924) 9 Tax Cases, 163.

Pondichery Railway Co. v. *The Commissioner of Income Tax, Madras,* (1931) L.R. 58 I.A. 239.

Perkin's Executor v. *England Revenue Commissioners,* (1928) 13 Tax Cases, 851.

Mersey Docks and Harbour Board v. *Lucas,* (1883) 2 Tax Cases, 25.

Costas Christodoulou, 20 Part I. C.L.R. 114 (Case stated No. 95, under Section 39 (9) of the Income Tax Law, Cap. 297).

Tata Hydroelectric Agencies Ltd. v. *The Income Tax Commissioner of Bombay*. (1937) A.C. 685.

The Inland Revenue Commissioners v. *Mallaby Deeley* (reported *sub. nom*: *The Inland Revenue Commissioners* v. *The Personal Representatives of Sir Mallaby Deeley, Bart*) (1938) 4 All E.R. 818.

Per curiam: As to the unfairness of collecting income tax twice in respect of the share allowed to the mother viz: from the covenantor (appellant - son) and from the husband of the covenantee - mother (*v. ante*, the head-note) all we can do is to endorse what the Court below said: this matter was neither a subject for decision in the Lower Court nor a subject of Appeal before us. If the Income Tax Authorities are willing to regard the sums handed over to the mother as being in the nature of capital disbursements, they are in a position to do so and refund the taxes collected from the husband.

Editor's Note: It would seem from the judgment of the Court that the sums paid to the mother being rather in the nature of capital disbursements, the Commissioner of Income Tax should not have included them in the assessment made on her husband. (v. *ante*, the head-note).

Case stated on questions of Law.

Case stated by the District Court of Limassol (ZENON, P.D.C.) (consolidated Income Tax Appeals Nos. 15, 16 and 17 of 1957) on the application of the appellant on the points: (1) Whether the portion of the rents of premises owned by him payable to his mother under the agreement dated the 9th July 1954 forms part and parcel of the appellant's income or not; (2) if that portion is considered to be for the purpose of the Income Tax Law the income of the appellant, whether the latter is entitled to a deduction allowance in respect thereof.

M. Houry for the appellant.
D. Goodbody, Crown Counsel, for the respondent.

Cur. Adv. Vult.

The facts sufficiently appear in the judgment of the Court, delivered by:

ZEKIA, J.: This is a Case Stated on a Question of Law for the opinion of this Court by the Limassol District Court under section 39 (9) of the Income Tax Law, Cap. 297.

The facts are that the appellant, Mr. Charis Georgallides of Limassol, had entered into an agreement with his mother,

Mrs. Katina Georghallides, on the 9th July, 1954, in the terms which appear in a contract in writing which we quote hereunder :

"AN AGREEMENT FOR THE SALE OF LIFE-INTEREST. An agreement for the sale of a life-interest in the income of the properties described below, made the 1st August, 1953 and put to writing this 9th day of July, 1954, between Charis E. Georghallides of Limassol (hereinafter called 'the First Party') of the one part and Katina E. Georghallides of Limassol (hereinafter called 'the Second Party') of the other part WITNESSETH :

In consideration of the sum of £9,087.11.3 (Nine thousand and eighty-seven pounds Sterling and eleven shillings and three piastres) which at present date is due and payable to the Second Party by the First Party, the First Party hereby sells to the Second Party a life-interest in a part of the income to be specified below, of the immovable property situated at Ledra Street, Nicosia, Numbers 208 to 214, as it stands at present date, consisting of a two-storeys building presently used and leased as an hotel and with three shops at the ground-floor, and which is solely registered in the name of the First Party, subject to the following special terms and/or essential terms and/or special conditions :

(a) The First Party will always be entitled to receive the basic sum of £105.0.0 (One hundred and five pounds) per month out of the whole monthly income of the said immovable, and the remaining monthly income, if any, where the total monthly income does not exceed the amount of £210.0.0. (Two hundred and ten pounds) per month will be received by the Second Party.

(b) When the total monthly income of the said immovable exceeds the sum of £210.0.0 (Two hundred and ten pounds) then it will be divided equally between the First and Second Party.

(c) Subject to the above terms and after the distribution of the income both parties will contribute equally towards the costs of the insurance (of whatever nature) of the said immovable, of all taxes, rates, charges and

water rates with which the owner (the First Party) is and/or would be charged in relation to it, and also for the costs of any repairs and/or any necessary alterations to the said immovable to be incurred by the First Party.

(d) If, in the future, any more storeys are added and/or erected on the said immovable the Second Party will have no right or interest or benefit whatever in their income, which will belong exclusively to the First Party.

(e) The rights of the Second Party in the said immovable by the present contract will be strictly non-transferable to any person and/or to any legal persons whatever, by the Second Party and they will continue to subsist only during the life-time of the Second Party. Further, the heirs and/or any legatee of the First Party will inherit subject to the provisions of the present contract as regards the said immovable.

(f) The First Party is given exclusively the right to cancel and/or terminate and/or renounce the present contract at any time whatever by paying to the Second Party the sum of £9,000.0.0. (Nine Thousand Pounds Sterling) as compensation and/or damages and/or as a new consideration for the right to buy off the rights of the Second Party in the present contract, in which case all the rights and liabilities given by the present contract upon the Second Party will cease to exist and the present contract would be totally cancelled.

(g) Also the present contract will be automatically terminated by the destruction of the said immovable caused independently of the will of either Party, in which case the Second Party will be entitled to the collection of half the amount of the whole of the insurance, if any, to be collected in relation to it by the First Party.

(h) Finally, the right of the administration of the said immovable will be entirely vested in the First Party, who may exercise absolutely his own discretion as to the leasing, and the amount of rent, and to all relevant matters thereto, with the right to keep the whole or part of it unleased for such period as he may think fit.

(i) The present contract is given effect and operates retrospectively since the 1st of August, 1953.

Made in Limassol, this 9th day of July, 1954.

Contracting Parties
(Sd) Ch. E. Georghallides
(Sd) Katina Georghallides".

The Income Tax Authorities treated the above agreement as valid and the share collected from the rents of the premises described in the contract was added to the income of the father of the appellant as being income of his wife, namely, that of Mrs. Katina Georghallides. On the 16th September, 1957, however, the Commissioner of Income Tax raised three additional assessments on the appellant for the sum of £1,008 for each of the years of assessment 1955, 1956 and 1957. The result was that the tax payable by the appellant was raised by £289.310, £309.030 and £359.125 respectively for the three years mentioned.

The Court found that—

"although the contract expressed in Exhibit 1 (the agreement) was legal and valid it was not effective alienation of income nor did it operate to transfer to applicant's mother a legal or equitable share in the income of the property therein mentioned, nor was it a valid creation of a trust, nor could it be treated as a settlement in the sense that this word has been used in the English Law, but was merely a covenant regulating the application of that income, which left the title thereto, legal and equitable, exclusively in the applicant".

The Court in another part of its statement refers to the income tax collected in respect of the mother's share in the rents of the premises from the husband by the Income Tax Authorities in the following words:

"The legality or propriety of the action of the Commissioner of Income Tax in treating the income derived by Mrs. Katina Georghallides under Exhibit 1 as being hers and for which her husband was taxed we were not able to investigate and determine because that question was not brought before us for investigation and determination".

One dealing with fiscal legislation should carefully examine first, whether the taxpayer is clearly within the words of the provisions by which he is charged with tax and, secondly, if he claims any exemption or deduction from tax—to which liability is either admitted or established—whether such claim is clearly supported by the relevant provision of the Law. In a disputed case the onus to satisfy the Court as to liability to pay tax is on the Tax Authorities and the onus to support a claim for exemption or deduction allowance is on the taxpayer.

It seems to us that in the present case the issues involved are two: (1) Does the share in the rents of the premises in question payable to the mother of the appellant form part and parcel of the income of the appellant or not? (2) if the share of the mother in the rents so collected is considered for the purposes of the Income Tax Law to be the income of the appellant, is he entitled to a deduction allowance in respect of the said income?

While the respondent has got to make a clear case for an affirmative answer to the first question, likewise it is upon the appellant to provide us with a similar answer in respect of the second question. The agreement under review was not challenged by the Commissioner as being fictitious and/or artificial with a view to escape liability of paying income tax on the amount involved. This he could do under section 52 (2) of the Law. On the contrary he regarded it as a valid transaction and taxed the share in the rents collected by the mother by including the sum in the assessment made on her husband.

We have to confine our attention, however, to the agreement itself and its effect on the issues involved, rather than what the Tax Authorities did with the appellant's mother in respect of the share in the rents collected from the premises of the appellant.

From the agreement in question it is clear, and it is a common ground in this case, that the mother advanced to her son the appellant the sum of £9,000 with a view to enable him to build the premises in question on sites already belonging to him and that in consideration of the amount

advanced the appellant agreed to let her receive during her life part of the monthly rents of the premises built.

Now, what is the effect in law of this contract which purports to give a life interest in part of the rents of the premises in question to the mother ?

Paragraphs (e), (f), (g) and (h) of the agreement give to the appellant the following powers: (a) the power of cancellation, and in that case the appellant would have to pay £9,000 to the mother as compensation; (b) the exclusive right to lease the property; (c) the fixing of the rent and (d) termination of the lease and indeed the right to keep vacant or unlet part or the whole premises. Provisions are made also that the immovable property tax, fees, insurance premiums, etc. will be shared by the parties and if there is destruction of the premises the amount collected from the insurance company will be divided between son and mother.

From the terms of the contract it is apparent that the title of the premises as well as the right to lease premises and terminate a lease, fix rents etc. is within the exclusive right and absolute discretion of the appellant, the son. He is the registered owner of the premises, he is the landlord and he has got the right solely to lease the premises in question. The tenants, the rent payers, are exclusively his tenants and answerable only to him for paying rents.

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?

There are no special provisions for modes of transfer or disposition of income for the purpose of Income Tax Law. This Court in *Costas Christodoulou's* case (1) held that dispo-

(1) 20 C.L.R. 119.

sition in section 50 (3) did not only include a disposition of income but of property yielding income also. It did not however deal with modes of transfer of income independently of corpus which might be held acceptable for the purposes of Income Tax Law.

The point did not arise in that appeal at all. The definition of the word 'disposition' given in the Law, Section 50 (5) (a) includes any trust, grant, covenant, agreement or arrangement. This does not help us in this case. 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 disponee, i.e. covenantee or trustee. In other words, there must be 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 promissor 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 disponor, the owner of income, in favour of his minor children and disposition in favour of persons generally, for periods which cannot exceed six years.

Now the word 'disposition' occurs in these provisions which is used in the sense defined in the Cyprus Income Tax Law. Our definition is a bit wider than the English definition because it includes the word 'grant' in addition which is not included in the English definition of 'disposition', but that makes no difference for the purposes of this appeal.

In Halsbury in the introductory paragraph to the said English provisions the word 'disposition' is taken to refer to the alienation of income. Para. 1112 at p. 571 of Halsbury's Laws of England, 3rd Edition, Volume 20, reads:

"Scope of the Part. The provisions discussed in this part

of the title have been designed to prevent the avoidance of tax by means of alienation of income (whether by covenant or settlement) in favour of persons whose liability to tax is less than that of the covenantor or settlor, or by means of the transfer of assets overseas or by means of the transfer of income arising from securities. Where by operation of general law the covenant, settlement or transfer is ineffective, there is in consequence no alienation of income, and the income remains that of the covenantor, etc., without the operation of these provisions".

Konstam's Income Tax, 12th Edition, at p. 348, deals with disposition effective for the purposes of sections 393 and 397 of the Income Tax Act and states:

"In view of the provisions considered in the preceding pages, it would be unsafe to generalise as to the classes of dispositions which may still transfer the income to the beneficiary for purposes of income tax and surtax, as well as for other purposes,"

and he cites a number of cases on transfer of income. By no means it is an easy matter to define the mode of a valid transfer of income for the purposes of the Income Tax Law. It is clear however that a disposition may affect in some way or other the destination of a particular income or part thereof without divesting the disponor of that income. In such cases sometimes it is difficult to draw the line. Probably a convenient test would be to consider the owner of the income in relation to the time it first accrues. The weight of authorities supports this view although some of them are not easily reconcilable with it. Those, for instance, referring to annual payments out of a particular income.

If we look at this transaction between mother and son as an assignment by the son of a share in future rents such assignment definitely falls short of absolute assignment.

In *Burlinson* v. *Hall* (1) which was followed by a number of cases it was held that by a charge the title is not transferred but the person creating the charge merely says that out of a particular fund he will discharge a particular debt.

(1) (1881) 12 Q.B.D. 347, 350 and Chitty, On Contracts, 21st Edition p. 443.

"In deciding whether an assignment is absolute or not the intention of the assignor is the determining factor. Did he intend to pass all his rights to the assignee? If the whole tenor of the document is to provide some security for a debt it is only a charge".

A summary statement of the Law on the distinction to be drawn between application and alienation of income is given in page 423 of Halsbury's Laws of England 3rd Ed. Vol. 20 which is worth quoting here:

"Application and alienation of income distinguished. The distinction between the application of income and the alienation of income is important. The mere application of income in pursuance of an obligation under a contract, other than a covenant to pay an annual sum, or under a statute, does not affect the ownership of that income or entitle the income so applied to be deducted from total income. On the other hand, where an effective gift, settlement, declaration of trust or transfer is made, declared or executed, the settlor is divested of his interest in the income, but a gift taking effect at a future date, dependent on the donee being alive at that date, does not vest the present income in the donee".

At paragraph 795 it is stated:

"Where a person purports to alienate his income in favour of another person the alienation, to be effective, must operate to divest immediately the beneficial interest of the alienator and vest it in the alienee. In the absence therefore of a completed transfer of property by the owner, there must be a valid trust created by him in the favour of the beneficiary.".

In the cases of the *Commissioner of Inland Revenue* v. *Patterson* (1), *Pondicherry Railway Co.* v. *The Commissioner of Income Tax, Madras* (2), *Perkin's Executor* v. *England Revenue Commissioners, 1928* (3) the difference is explained as between alienation or assignment of income and payment made out of income, in other words, application of income. Lord MacMillan delivering his judgment in the Privy Council in *Pondicherry* case, stated:

(1) (1921) 9 Tax Cases, 163.
(2) (1931) L.R. 58 I.A. 239.
(3) (1928) 13 Tax Cases, 851.

"A payment out of profits, and conditional on profits being earned, cannot accurately be described as a payment made to earn profits. It assumes that profits have first come into existence. But profits, on their coming into existence, attract tax at that point, and the revenue is not concerned with the subsequent application of the profits".

Rowlatt, J. in *Perkin's Executor* v. *Inland Revenue* adopted the following test of alienation (*supra*) at p. 858:

"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 though he may be obliged to do so still that remains his income".

In the case of *Mersey Docks and Harbour Board* v. *Lucas* (1) the Harbour Board was directed under an Act of Parliament to pay the surplus of its income after meeting expenses and interest charges into a sinking fund to extinguish the debt incurred in the construction of its docks. It was held that the surplus was profit assessable to income tax. In his judgment Lord Selborne, L.C. stated (pp. 28, 31):

"The word 'profits' as here used means the incomings of the concern after deducting the expenses of earning and obtaining them before you come to the application of them.... It is exactly the same thing as if there had been a declaration that after paying the current expenses and all other necessary outgoings.... the clear surplus of the profits and gains of the undertaking should be applied in a certain manner. The mode of application makes no difference whatever to the question of what is a profit or gain".

Lord Blackburn stated (*loc. cit.* at p. 33):

"There is nothing in the Act to say that when an income has been actually earned, when an actual profit upon which the tax is put is earned and received by any person or corporation, Her Majesty's right to be paid the tax out of it in the least degree depends upon what they are to do with it afterwards".

(1) (1883) 2 Tax Cases, 25.

We do not think that there is sufficient reason for us to differentiate on this point the Revenue Law of this Country from similar legislation obtaining in England.

The answer, therefore, to the first issue is in the affirmative.

We come now to the second issue, namely, whether the sum in the form of a share in the rents collected by the appellant allocated to his mother could be deducted from his total income. As we intimated earlier it was up to him to show clearly that he was entitled to a deduction under a particular provision of the Income Tax Law. This in our opinion he failed to do.

Section 10 (1) of the Income Tax Law reads:

> "For the purpose of ascertaining the chargeable income of any person, there shall be deducted all outgoings and expenses wholly and exclusively incurred during the year immediately preceding the year of assessment by such person in the production of the income....".

The relevant sections of our law as to allowable deductions are sections 10, 11, 12 and 14. In section 12 (e) under the heading "Deductions not to be allowed" it is mentioned:

> "Any disbursements or expenses not being money wholly and exclusively laid out or expended for the purpose of acquiring the income".

The nature of the payment involved is the criterion whether it is of a capital nature or expenses envisaged by section 10 (1) which are deductable for the purpose of ascertaining the chargeable income of the person.

In *Tata Hydroelectric Agencies Limited* v. *The Income Tax Commissioner of Bombay* (1) it is stated:

> "The appellant company had purchased a business of managing agents, taking over all benefits and liabilities; the vendors, for services rendered to them, had covenanted to pay 25 per cent of the commissions they received for managing a third company to persons who had lent this company money; by new and identical agreements a complete novation had been effected and the appellants

(1) (1937) A.C. 685.

had taken the place of the vendors. They claimed that this share of the commission which they had now to pay was an expense incurred in earning their profits and therefore an admissible deduction in arriving at their taxable profits".

It was held by the Privy Council that the payment in question was an application of profit and not deductable: Lord MacMillan in his judgment stated:

"This payment was an application of profit already earned and not a cost of earning the profits; the payment was also held to be of a capital nature being part and parcel of the terms of the purchase of the business".

In the case of *Mallaby Deeley and another v. The Commissioners of Inland Revenue* (1) the facts were: The appellant (since deceased) undertook to pay a sum of money in five equal amounts to finance the completion of a literary work. On 10th March, 1930, he entered into a deed of covenant (which was exchanged for the original undertaking, but contained no reference to it in terms) to pay in each of seven years ending 31st March, 1936, sums, after deductions of Income Tax, ranging from £5,600 in the first year to £700 in the last year, which amounted in the aggregate to the balance remaining due at 1st April, 1929, under the original undertaking. On appeal against certain assessments to Sur-tax on the ground that the respective amounts payable under the deed of 10th March, 1930, with an appropriate addition for Income Tax, were proper deductions in computing the appellant's total income for Sur-tax purposes for the years concerned, the Special Commissioners decided (1) that the payments under the deed were income payments, but (2) that the deed was not 'a disposition made for valuable and sufficient consideration' within the meaning of Section 20 (1) (b), Finance Act, 1922, and (3) that, in the computation of the appellant's liability to Sur-tax, the deductions allowable in respect of the payments under the deed must be restricted each year to the gross amount, before deduction of Income Tax, corresponding to the net sum of £700, as being the only amount payable for more than six years. The Court of Appeal held that the payments under the deed were of a capital nature, inadmissible as deductions for

(1) (1938) 4 All E.R. 818.

Sur-tax purposes. Sir. W. Greene, M.R. in giving the judgment of the Court at pp. 826—27 stated :

"On the other hand, if there is a real liability to pay a capital sum, either pre-existing or then assumed, that capital sum has a real existence, and, if the method adopted of paying it is a payment by instalments, the character of those instalments is settled by the nature of the capital sum to which they are related. If there is no pre-existing capital sum, but the covenant is to pay a capital sum by instalments, the same result will follow.

Now, proceeding upon that basis, the position at the date when the deed of the 10th March, 1930, was executed was that Sir Harry was under an obligation to pay a capital sum, or what was left of a capital sum, of £28,000 by certain annual instalments. That obligation he gets rid of, substituting for it the obligation under the deed. It seems to me that, putting all those circumstances together, what he was doing under the deed of the 10th March, 1930, was that he was liquidating a capital obligation of his own, an obligation which, it is true, was only to be carried out by instalment payments, but which nevertheless was of a capital nature, and he was liquidating that obligation by a series of instalments differring in amounts and times from those which were referred to in the pre-existing document. *On that basis, it seems to me that the case is one where it is not possible to say of the payments made under this document that they are of an income nature.* They are given the character of capital; that character is stamped upon them by the circumstance that they are the means of liquidating a capital obligation, and it is quite wrong to say that you must look at the document alone and disregard the other elements in the legal relationship between the parties and the legal results which the transaction achieved".

In the present case a loan of £9,000 was contracted by the son from the mother which was expended for the building of the premises. The appellant undertook the contractual obligation to repay the said sum by allocating part of the rents collected. The debt in question will be considered extinguished by the death of the mother. This looks more or less a capital disbursement. The argument by the able

counsel for the appellant that the payment in question might be taken to meet interest on the money lent by the mother is difficult to be accepted because there is no stipulation as to the payment of interest and if it was a matter only to meet interest then the principal advanced would have continued to exist unextinguished even after the life of the mother.

We think that the Court below was correct in the conclusion they have come to. The learned Counsel for the appellant directed a great part of his argument to the unfairness of collecting income tax from the share allowed to the mother twice: from the covenantor and from the covenantee separetely. All we can do is to endorse what the Court below said, that this was not a subject for decision in the lower Court and not a subject of appeal before us. If the Income Tax Authorities are willing to regard the sums handed over to the mother in the nature of capital disbursements they are in a position to do so and refund the taxes collected from the mother. Mr. Houry contended that if his argument failed the Court should find that there was a partnership between the mother and son; that what the mother was collecting is an outgoing expense under section 10 of the Law, *viz.* expense which is incurred to enable the son to earn the income so that the share going to the mother should be considered as an outgoing expense wholly and exclusively incurred during the year to enable him to earn the income. The contract under review was made after the completion of the premises. There is no room for the assumption of a partnership. As to the suggestion to regard the payment out of rents as an outgoing expense under section 10 of the law, we have already indicated our view on this point and we do not think that we need revert to it again. The appeal is dismissed with costs. The decision of the Court below is affirmed.

Decision of the Court below affirmed.