IN THE MATTER OF ARTICLE 146 OF THE CONSTITUTION

CYPRUS WINES CO. LTD.,

Applicant,

and

THE REPUBLIC OF CYPRUS, THROUGH THE COMMISSIONER OF INLAND REVENUE,

Respondent.

(Case No. 126/64).

Administrative Law—Taxes—Income Tax—Assessments—Law 16 of 1961 of the Greek Communal Chamber, section 4(1)—Distinction between a capital receipt and a trading profit for purposes of assessment of income tax—Whether a sum paid to applicant as damages for the infringement of his registered trade mark is income derived in respect of a trading profit, chargeable with tax under the Law, or is a capital receipt not so chargeable.

The Applicant is a limited company incorporated in Cyprus, having its registered office in Limassol, and manufactures wines and exports same to particular countries abroad.

The only issue for determination in this case is whether a sum of £1,000 paid to the Applicant in 1960, consequent upon an infringement of the Applicant's registered trade mark in Sierra Leone, is income derived in respect of a trading profit and, therefore, as such, chargeable with tax under Law 16 of 1961 of the Greek Communal Chamber or whether the said sum is a capital receipt and is not, therefore, so chargeable.

It has been submitted by counsel for Applicant that the sum of £1,000, which was received as a result of the infringement of the trade mark, does not constitute a trading profit but is a capital receipt arising from injury caused to a capital asset, and is not, therefore, taxable under the provisions of Law 16 of 1961 of the Greek Communal Chamber.

On the other hand counsel for Respondent, while conceding that the trade mark which was infringed is a capital item submitted that the trade mark itself, as such, had not

been affected by the infringement and it was the trade of the Applicant which had suffered as a result thereof and that the damages of £1,000, which were paid in respect of the infringement were made towards making good the loss occasioned by the reduced sale of the Applicant's products which the trade mark had been used to identify; and that the sum in question was trading profit, and, as such, was taxable under the relevant provisions of the aforesaid Law 16 of 1961.

Held, 1. On the facts of this particular case, and, having regard to all the circumstances and the manner in which the sum of £1,000 in question was paid to the Applicant, such sum was a capital receipt in the hands of the Applicant and it was not, therefore, received in respect of "gains or profits from any trade, business, profession or vocation" carried on by the Applicant.

2. This being so, the decision of the Respondent dated 9th October, 1964, to include the item of £425 as being tax payable under Law 16 of 1961 of the Greek Communal Chamber in the assessment made for the year of Assessment 1961 in respect of the sum of £1,000 in question, which was received by the Applicant in 1960, must be declared *null* and *void* and of no effect whatsoever.

Decision complained of declared null and void.

Cases referred to:

Harry Ferguson (Motors) Ltd. v. I.R. Commissioners (1951) *N.I.*, 115, C.A.;

Burmah Steam Ship Company Ltd., v. I.R. Commissioners, 16 T.C. 67;

Van den Berghs Ltd. v. Clark (H.M. Inspector of Taxes) [1935] A.C.431, 19 T.C. 390;

Orchard Wine and Spirit Company v. Loynes (H.M. Inspector of Taxes) 33 T.C., 97.

Recourse.

Recourse against the decision of the respondent to treat as income a sum of £1,000, received by Applicant as damages

in connection with an infringement of the applicant's trade mark.

Pan. Cacoyannis for the applicant.

L. Loucaides, Counsel of the Republic, for the respondent.

Cur. adv. vult.

The following judgment was delivered by:

MUNIR, J.: By this recourse under Article 146 of the Constitution the Applicant attacks the decision of the Respondent to treat as income a sum of £1 000, which was received by the Applicant, as damages in connection with an infringement of the Applicant's trade mark, and the subsequent inclusion in the assessment of tax made on the Applicant, in respect of the year of assessment 1961, of the sum of £425 as being the tax payable on the said sum of £1,000. The assessment of the said tax of £425 was notified to the Applicant by Respondent by Form I.R. 32 (Notice of Payment of Income Tax) dated the 9th October, 1964.

The salient facts of this case, which are not in dispute, may briefly be stated as follows:

The Applicant is a limited liability company incorporated in Cyprus, having its registered office in Limassol. The Applicant has a big and up-to-date wine factory and also manufactures special types of wines suitable for export to particular countries abroad.

In 1954 the Applicant commenced exporting to Sierra Leone a certain type of wine, which was specially manufactured by it for the Sierra Leone market where it was sold under a trade mark called "St. Nicholas". This trade mark was duly registered by the Applicant in Sierra Leone. This special type of wine was only sold in Sierra Leone and was not exported to any other country.

In 1954 the sales of the Applicant's wine to Sierra Leone amounted to 63,520 litres of the value of £3,983. These sales were increased from year to year and in 1956 they reached the amount of 1,053,670 litres which was of the value of £65,978. During the first three months of 1957 the sales of the Applicant's wine on the Sierra Leone market amounted to 402,000 litres.

At the end of February, 1957, a certain Joseph Matar of Lebanon, who was also trading, *inter alia*, in wines in Sierra Leone, placed on the Sierra Leone market a certain type of wine which was sold under a trade mark called "St. Stanislas". This trade mark closely resembled the Applicant's trade mark "St. Nicholas" in colour, print, design and general appearance.

Consequent upon the introduction onto the Sierra Leone market of Joseph Matar's new wine under his new trade mark the sales of the Applicant's wines in Sierra Leone during the last nine months of 1957 dropped to the meagre amount of 372,000 litres. For the whole of 1958 the Applicant's wine exports to Sierra Leone had fallen to 217,325 litres of a value of £11,994. The sales subsequently dropped from year to year until the year 1964, during which year no wine was exported by the Applicant to Sierra Leone. Details of the Applicant's sales to Sierra Leone between the years 1954 and 1965 are shown on the list which was produced by the Applicant's witness Andreas Michaelides and put in as *Exhibit* No. 1. No wine has been exported by the Applicant to Sierra Leone since 1964.

In 1957 the Applicant instituted proceedings in the Sierra Leone courts against Joseph Matar and in February, 1958, the competent Sierra Leone court issued an injunction restraining the said Joseph Matar from infringing the Applicant's trade mark. No damages were in fact assessed or awarded by the Sierra Leone Court. In 1960, however, Applicant received from Joseph Matar an offer of £1,000 as damages for the infringement. This offer was accepted by the Applicant for what it was worth and by this acceptance further proceedings were discontinued and the question of damages was thus settled out of court.

It has been submitted by counsel for Applicant that the sum of £1,000, which was received as a result of the infringement of the trade mark, does not constitute a trading profit but is a capital receipt arising from injury caused to a capital asset, namely, the Applicant's trade mark and is not, therefore, taxable under the provisions of Law 16 of 1961 of the Greek Communal Chamber.

On the other hand counsel for Respondent, while conceding that the trade mark which was infringed is a capital item, submitted that the trade mark itself, as such, had not been

affected by the infringement and that it was the trade of the Applicant which had suffered as a result thereof and that the damages of £1,000, which were paid in respect of the infringement, were made towards making good the loss occasioned by the reduced sale of the Applicant's products which the trade mark had been used to identify. This being so, counsel for the Respondent submitted that the sum in question was trading profit, and, as such, was taxable under the relevant provisions of the aforesaid Law 16 of 1961.

The only oral testimony given in the case was that of the witness Andreas Michaelides, who was called on behalf of the Applicant. This witness, who is one of the senior officers of the Applicant, and whose evidence I accept, gave details of the wine business of the Applicant in Sierra Leone and in particular gave evidence of an oral offer which had been made in Sierra Leone to the Applicant by an Indian trader, named Choithram, whereby Choithram had offered to pay the Applicant the sum of £3,000 in cash, payable over a period of time, in consideration for the Applicant allowing Choithram to be registered as the co-owner of the Applicant's trade mark "St. Nicholas" or alternatively to be allowed to have printed on the trade mark labels affixed to the bottles of the Applicant's wine that Choithram was a bottler of the Applicant.

The only issue for determination in this case is simply whether the sum of £1,000 paid to the Applicant in 1960, consequent upon an infringement of the Applicant's registered trade mark in Sierra Leone, is income derived in respect of a trading profit and, therefore, as such, chargeable with tax under Law 16 of 1961 of the Greek Communal Chamber or whether the said sum is a capital receipt and is not, therefore, so chargeable.

The relevant statutory provision governing this matter is sub-section (1) of section 4 of the said Law 16 of 1961 which in this respect appears to be identical with the corresponding provision, namely, sub-section (1) of section 5 of the former Income Tax Law, Cap. 323. Paragraph (*a*) of both sub-section (1) of section 4 of Law 16 of 1961 and of sub-section (1) of section 5 of Cap. 323 provide, *inter alia*, that tax shall be payable upon the income of any person accrued in, derived from, or received in respect of "gains or profits from any trade, business, profession or vocation".

This question of the distinction between a capital receipt and a trading profit is one which has been the subject-matter of many tax cases in the courts in England, where statutory provisions similar to our statutory provision referred to above have existed for many years. This distinction is so fine and so technical that it is not always easy, even after exhaustive study of the prolific case law on the subject, to know exactly where to draw the line. How very fine the distinction is may be amply illustrated by the very fact that what may be a capital item in the accounts of one taxpayer might, in the particular circumstances of another bear an income character I fully share the views expressed by Lord MacDermott, C J, in the case of *Harry Ferguson (Motors) Ltd* v *I R Commissioners* (1951) N.I., 115, C.A., when he stated —

> "There is, so far as we are aware, no single, infallible test for settling the vexed question whether a receipt is of an income or capital nature. Each case must depend on its particular facts and what may have weight in one set of circumstances may have little weight in another. Thus, the use of the words 'income' and 'capital' are not necessarily conclusive; what is paid out of profits may not always be income; and what is paid as consideration for a capital asset may, on occasion, be received as income One has to look to all the relevant circumstances and reach a conclusion according to the general tenor and combined effect"

A test was suggested by Lord Clyde in the case of *Burmah Steam Ship Company Ltd* v *I R. Commissioners*, 16 T C 67, which was a case in which joint owners of a vessel which they had bought at second hand, placed it with repairers who exceeded the stipulated time of the completion of overhaul. Damages were paid in compromise of a claim in respect of the estimated loss of profit from trading with the ship. The Court of Session held that the appellant's share of the damages was a trading receipt Lord Clyde suggested the following test in his judgment (page 71)

> "Suppose some one who chartered one of the appellant's vessels breached the charter and exposed himself to a claim of damages at the appellant's instance, there could, I imagine, be no doubt that the damages recovered would properly enter the appellant's profit and loss

account for the year. The reason would be that the breach of the charter was an injury inflicted on the appellant's trading, *making (so to speak) a hole in the appellant's profits*, and the damages recovered could not therefore be reasonably or appropriately put by the appellant—in accordance with the principles of sound commercial accounting—to any other purpose than to fill that hole. Suppose, on the other hand, that one of the appellant's vessels was negligently run down and sunk by a vessel belonging to some other shipowner, and the appellant recovered as damages the value of the sunken vessel, I imagine that there could be no doubt that the damages so recovered could not enter the appellant's profit and loss account because the destruction of the vessel would be an injury inflicted, not on the appellant's trading, but on the capital assets of the appellant's trade, *making (so to speak) a hole in them*, and the damages could therefore—on the same principles as before—only be used to fill that hole".

It will be seen from the above-quoted passage that the test suggested is whether the thing in respect of which the taxpayer has recovered the damages is the deprivation of one of the capital assets of his trading enterprise or mere restriction of his trading opportunities.

Counsel for Respondent has invited me to apply the above test and has submitted that its application to the facts of the present case should result in the conclusion that the sum of £1,000 in question had been received by the Applicant as a trading profit.

On the other hand, counsel for Applicant has largely based his argument on the decision of the House of Lords in the well-known case of *Van den Berghs Ltd.* v. *Clark (H.M. Inspector of Taxes)*, [1935] A.C. 431, 19 T.C. 390. The sum in question in *Van den Berghs' Case (supra)* was received on the compromise of a dispute arising out of three successive agreements whereby the appellant company and another had for many years co-operated in the respondent's undertakings sharing the profits and losses proportionately. The House of Lords held the cancellation monies to be capital receipts.

Counsel for Applicant has invited the Court to distinguish the case of *Orchard Wine and Spirit Company* v. *Loynes (H.M.*

Inspector of Taxes) 33 T.C., 97, where, on the facts of that particular case and having regard to the nature of the agreement in question, in that case, it was held that the sum payable was not a capital receipt.

Having given most careful and anxious consideration to the able arguments submitted by counsel on both sides, to the authorities respectively cited by them and to as many other authorities on the subject as I myself have been able to examine, I still endorse the views expressed by Lord MacDermott in the above-quoted passage from his judgment in the *Harry Ferguson* (*Motors*) *Case* (*supra*), namely, that each case must depend on its particular facts and that there "is no single, infallible test for settling the vexed question of whether a receipt is of an income or capital nature".

The facts of this case are fortunately very simple and are not in dispute in any material particular. Counsel for Respondent, both in the written Opposition and in his argument before the Court, has readily conceded quite rightly in my opinion, that the trade mark in question which was infringed is a capital item.

Can it be said that the sum of £1,000 which has been paid to the Applicant for infringement of this trade mark, in other words, for the damage caused to this capital item, is receipt of an income nature as a trading profit? In my opinion, having regard to all the facts, and circumstances in which the sum in question was paid (e.g. that it was paid as a lump sum, in an out-of-court settlement, for the infringement of the Applicant's trade mark, i.e. for damage caused to a capital item) such sum should, and must be, regarded as a capital receipt and should not, therefore, be liable to tax under paragraph (*a*) of sub-section (1) of section 4 of Law 16 of 1961.

It is true that, as submitted by counsel for Respondent, Applicant's trade has suffered as a result of the infringement of the trade mark and, consequently, its trading profits were considerably diminished. This does not, in my opinion, however, necessarily mean that the sum in question must, therefore, be regarded as a trading profit and not as a capital receipt. Indeed, it is difficult to envisage any case in which the capital asset of a taxpayer is damaged or completely destroyed and where such damage or destruction does not inevitably result in a subsequent loss of profit. For example,

if a ship-owner's vessel is damaged or destroyed any damage paid to the owner would still be a capital receipt, notwithstanding the fact that the damage or loss of such vessel would also adversely affect the trade and trading profits of the ship-owner. Applying, for example, Lord Clyde's test in the *Burmah Steam Ship Company Case* (*supra*), I am of the opinion that the sum in question paid to the Applicant in this case was paid not as a result of injury directly inflicted on the Applicant's trading, "making (so to speak) a hole" in it, but as a result of an injury inflicted on the capital assets of the Applicant's trade (i.e. the trade mark) making (so to speak) a hole in it. Any hole made in the capital assets of a person's trade must of necessity inevitably also result in loss of trade and trading profits but this does not mean that any payment made as a result of a hole made in a capital asset must, therefore, be trading profit.

I should here like to refer also to a possible test which is suggested in Halsbury's "Laws of England", 3rd Edition, Vol. 20 at page 14, which is as follows:

> "A sum received for a consideration affecting the *whole structure of the taxpayer's profit-making apparatus is usually capital;* on the other hand if the occasion for the payment is a temporary and variable element in the taxpayer's business the sum is of the nature of income".

In this case the sum in question was clearly "received for a consideration affecting the *whole* structure of the taxpayer's profit-making *apparatus*" inasmuch as it was paid as a result of injury caused to the applicant's trade mark which must, in my opinion, be regarded as part and parcel of the applicant's profit-making apparatus; furthermore, the occasion for the payment of the said sum is clearly not a "temporary and variable element in the taxpayer's business".

Another point to bear in mind, and which has weighed with me in coming to the conclusion which I have, is that the business carried on by the Applicant was one of manufacturing, exporting and selling wines and not the business of dealing with, or trading in, trade marks. Had the Applicant's business been one of trading, or dealing, in trade marks then it might well be said that the sum in question received for damage caused to such trade or business in trade marks must be regarded as a trading profit. In his judgment in the *Van den Berghs' Case* (*supra*) Lord Mac-

Millan, at pages 430-431, stated as follows:

> "I now address myself to the question whether the £450,000 received by the Appellants in the circumstances already narrated can properly be described as an item of profit arising or accruing to them from the carrying on of their trade, which ought to be credited as an income receipt. It is important to bear in mind at the outset that the trade of the Appellants is to manufacture and deal in margarine, for the nature of a receipt may vary according to the nature of the trade in connection with which it arises. *The price of the sale of a factory is ordinarily a capital receipt, but it may be an income receipt in the case of a person whose business it is to buy and sell factories.*"

Likewise, I would say that it is important to bear in mind at the outset in this case that the trade of the Applicant is to manufacture and deal in wines and not to trade or deal in trade marks. Just as the price for the sale of a factory is ordinarily a capital receipt so in my opinion is a sum paid for the sale of, or injury to, a trade mark a capital receipt. Such sum may, of course, be an income receipt in the case of a person whose business it is to buy or sell trade marks.

I should also like to observe that it does not appear to be in dispute that during the three years, 1955, 1956 and 1957, the Applicant had made a profit of about £60,000 which means that in a normal year the trading profits of the Applicant were approximately in the region of £15,000 to £20,000 a year. This being so, it can hardly be seriously contended that the lump sum of a mere £1,000 was paid by Joseph Matar to the Applicant as compensation for loss of trading profits amounting to approximately £15,000 to £20,000 a year, or that it was received by the Applicant as such. This vast difference between the sum paid and the annual loss of trading profits would also appear to support the view that the sum was not paid, as submitted by counsel for Respondent, as consideration for loss of profits.

For the reasons given above I am of the opinion that, on the facts of this particular case, and, having regard to all the circumstances and the manner in which the sum of £1,000 in question was paid to the Applicant, such sum was a capital receipt in the hands of the Applicant and it was not, therefore, received in respect of "gains or profits from any trade,

business, profession or vocation" carried on by the Applicant.

This being so, the decision of the Respondent dated 9th October, 1964, to include the item of £425 as being tax payable under Law 16 of 1961 of the Greek Communal Chamber in the assessment made for the year of assessment 1961 in respect of the sum of £1,000 in question, which was received by the Applicant in 1960, must be declared *null* and *void* and of no effect whatsoever.

Decision complained of declared null and void. No order as to costs.