[LOIZOU, J.]

IN THE MATTER OF ARTICLE 146 OF THE CONSTITUTION

THE MANUFACTURERS LIFE INSURANCE CO.,

Applicant,

and

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

Respondent.

(Case No. 163/66).

Income Tax—Assessments—Allowable deductions for income tax purposes—Ex gratia *payments made by the Applicant Insurance Company to its dismissed employees in connection with, and as a result of, its decision to discontinue new insurance business in Cyprus—Such payments do not qualify as allowable deductions for the purposes of income tax—Because they were not made wholly and exclusively for the purpose of enabling the Company to carry on its business and earn income—But rather for the purpose of enabling it to restrict its business without causing undue hardship to its employees—The Income Tax (Foreign Persons) Law,* 1961, *sections* 11 *(1) and* 13 *(e).*

Deductions—Income Tax—Allowable deductions—Test of—See above.

Words and Phrases—"Any disbursements or expenses not being money wholly and exclusively laid out or expended for the purpose of acquiring 'the income'" within section 13(e) *of the Income Tax (Foreign Persons) Law,* 1961—*See above.*

Words and Phrases—"Outgoings and expenses wholly and exclusively incurred by such person in the production of the income", within section 11 *(1) of the aforesaid Law.*

By this recourse under Article 146 of the Constitution the Applicant Company challenges the validity of assessment of income tax for the year of assessment 1965, on the ground that the Commissioner of Income Tax declined to consider certain payments by the Applicant as a deductible expense for income tax purposes. The Applicant is an Insurance Company who has been carrying on life insurance business in Cyprus since

1946. Its head office is in Canada. In the course and for the purposes of its business in Cyprus the Applicant appointed a number of agents whose duty it was to canvass for applications for insurance and annuities, and to collect money due to the Company in respect of applications or policies obtained through them or from policy holders allotted to them for the time being by the Company.

Payment to these agents was on a commission basis. In addition to the commission the agents were, under the terms of the contract of appointment, in certain circumstances entitled to some other benefits, including pension benefits. The contract of employment could be terminated at any time by either party giving to the other fifteen days' notice in writing.

In 1964, the Applicant Company decided to discontinue new insurance business in Cyprus but to continue with the servicing of their existing policies. As a result, the services of their agents were no longer required and their contracts of appointment were duly terminated. Although not bound by the terms of the contracts of appointment the Applicant Company paid to those agents what have been described as " termination grants " and in the case of two employees repatriation expenses. The extent of the termination grant paid to each agent depended on his years of service and his emoluments. The total sum so paid amounts to £12,098 or thereabout. In its income returns for the year of assessment 1965, the Company deducted these *ex gratia* payments from its trading receipts, but the Commissioner of Income Tax disallowed the deduction on the ground that the expenditure in question falls under section 13 *(e)* of the Income Tax (Foreign Persons) Law, 1961, and not under section 11(1) thereof. It is this decision of the Commissioner which is being challenged by the present recourse.

Sections 11(1) and 13(*e*) of the aforesaid Law provide :

" 11 (1). For the purpose of ascertaining the chargeable income of any person there shall be deducted all outgoings and expenses wholly and exclusively incurred by such person in the production of the income.....

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

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

The point at issue in this case was whether or not these *ex gratia* payments could properly be said to be money " wholly and exclusively laid out or expended for the purpose of acquiring the income ".

It was argued by counsel on behalf of the Applicant that the payments in question were deductible expenses for income tax purposes within section 11(1) *(supra)*, on the ground that they were made for the purpose of pleasing the employees concerned and preserving the good will of the Company.

In dismissing the recourse and after considering the authorities, the Court :

Held, (1)(*a*). It clearly appears from the authorities cited that for a payment to qualify as a deductible expense for income tax purposes it must be a payment connected with the trade or business carried on and *made* in order to enable the tax-payer the better to carry on his trade or business for the purpose of earning the income, whether by getting rid of onerous service agreements or for the purpose of maintaining a high standard of business.

(b) This seems to be in complete accord with the provisions of sections 11(1) and 13 *(e)* of our law *(supra)*.

(2) *(a)* It is, therefore, pertinent to consider the object of the disputed payments in the present case.

(b) It cannot be said that the sole object with which the Applicant company made the *ex gratia* payments in question was to enable the company to continue to carry on and acquire income in its business.

(c) It seems to me that these payments, which were incidental to the decision to discontinue new insurance business in Cyprus, were made for the purpose of enabling the company to give effect to this decision without causing hardship to its agents.

(d) Such payments cannot, in my view, be said to have been made wholly and exclusively for the purpose of enabling the company to carry on its business and earn income but rather for the purpose of enabling it to restrict its business.

(3) In the circumstances I think that it was open to the Commissioner to come to the conclusion that the payments in question are not allowable deductions for income tax purposes

and, therefore, I cannot interfere with such decision. In the result this recourse fails.

Application dismissed with costs assessed at £15.

Cases referred to :

Smith v. *Incorporated Council of Law Reporting*, 83 L.J. K.B. 1721, at p. 1726 per Scrutton J.;

Hancock v. *General Reversionary and Investment Co.* 88 L.J. K.B. 248 ;

Mitchell v. *B. W. Noble Ltd.*, 96 L.J. K.B. 484;

Anglo-Persian Oil Co. v. *Dale*, 100 L.J. K.B. 504;

Godden (H. M. Inspector of Taxes) v. *A. Wilson's Stores (Holdings) Ltd.*, 40 Tax Cases 161 ;

Commissioners of Inland Revenue v. *Anglo-Brewing Company Ltd.* 12 Tax Cases 803 ;

Strong and Company of Romsay Ltd., v. *Woodifield*, 5 Tax Cases 215.

Recourse.

Recourse against the validity of an income tax assessment for the year of assessment 1965.

A. Triantafyllides, for the Applicant.

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

Cur. adv. vult.

The following Judgment was delivered by:

LOIZOU, J.: The present recourse concerns the validity of assessment of Income Tax No. B498/65/1524/66 for the year of assessment 1965. It is based on the ground that the Commissioner of Income Tax declined to consider certain payments made by the Applicant as a deductible expense for Income Tax purposes.

The Applicant is an Insurance Company who has been carrying on life insurance business in Cyprus since about 1946. The head office of the Company is in Canada.

In the course and for the purposes of its business in Cyprus the Applicant appointed a number of agents whose duty it was

to canvass for applications for insurance and annuities, and to collect money due to the Company in respect of applications or policies obtained through them or from policy holders allotted to them for the time being by the Company

Payment to these agents was on a commission basis and by the terms of the contract of appointment (*exhibit* 1) they were prevented from devoting any part of their time, talents or energies to the business of any other undertaking transacting life or endowment insurance or annuity or other like business or from doing business with any such undertaking, either directly or indirectly, without permission of the Company, or from inducing agents to leave the Company's service, or persuading policy holders to discontinue their policies, or otherwise from doing anything prejudicial to the Company's interests

In addition to the commission the agents were, under the terms of the contract of appointment, in certain circumstances entitled to some other benefits, including pension benefits, depending on the length of their service and the amount of the business transacted by them The contract could be terminated at any time by either party giving to the other 15 days' notice in writing

In 1964, in view of a bill which was subsequently published in Supplement No 6 to the Gazette of the 14th April, 1966, the object of which was to regulate insurance business, the Applicant Company decided to discontinue new insurance business in Cyprus but to continue with the servicing of their existing policies.

As a result of the discontinuance of new insurance business the services of their agents were no longer required and their contracts of appointment were terminated

Although not bound by the terms of the contracts of appointment the Applicant Company paid to those agents what have been described as "termination grants" and in the case of two employees repatriation expenses The extent of the termination grant paid to each agent depended on his years of service and his emoluments The total sum so paid appears at paragraph 4 of the facts in support of the Application.

In its income tax returns for the year of assessment 1965, the Company deducted these *ex gratia* payments from its trading receipts. The Commissioner of Income Tax by his letter dated 15th July, 1965, (*exhibit* 2) disallowed the deduction, paragraph 'C' of this letter reads as follows

"C. The amount of £12,098 paid by way of termination grants to the local agents is not an allowable deduction being expenditure incurred not in the production of income but in connection with the ceasing of doing any more insurance business in Cyprus. Apart from this payment if any other payment incurred in connection with the decision to stop doing business in Cyprus, is similarly disallowable and you are requested to let me have details of such payments, if any".

In reply to the above letter the resident manager of the Applicant Company wrote the letter dated 8th November, 1965, (*exhibit* 3) in which he comments as follows:

"Although the writing of *new* business in Cyprus has ceased the Company will continue to carry on insurance business and income which will be liable to Cyprus Income Tax, will continue to accrue to the Company from annual premiums on policies which have already been issued. In view of this we do not agree with your contention that the Company 'has ceased doing any more insurance business in Cyprus'.

On the same basis we consider that the travelling expenses of Messrs. Hamlin & Kaplanian should be allowed to the Company.

In addition we consider that irrespective of whether the Company has ceased doing insurance business or not, both the termination grants paid to the agents and the repatriation expenses of Messrs. Hamlin & Kaplanian had been accruing over the period that the agents and the repatriated employees were connected with the Company and should, therefore, be allowed as deductible expenses from the Company's income".

By a letter dated 20th May, 1966 (*exhibit* 4), the Commissioner rejected the Applicant's contention and forwarded to him a Notice of Tax. Paragraphs 2 and 3 of this letter read as follows:

"2. I have since given the matter fresh consideration but I regret to inform you that I still consider that the amount of £15,562 for termination grants to agents as well as the amount of £1,219, for travelling expenses for officers who stopped employment as a result of the discontinuance of the carrying on by the company of new business in Cyprus, are not allowable deductions.

"3. My ground for this decision is that this expenditure falls under section 13(e) of the Income Tax (Foreign Persons) Law, of 1961, as it is not an expense wholly and exclusively expended for the purpose of acquiring the company's income".

The relative provision in our Law is contained in sections 11 and 13(e) of the Income Tax (Foreign Persons) Law, 1961, which read as follows:

"11(1). For the purpose of ascertaining the chargeable income of any person there shall be deducted all outgoings and expenses wholly and exclusively incurred by such person in the production of the income .....

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

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

The point that I have to consider in this case is whether these *ex gratia* payments can properly be said to be money "wholly and exclusively laid out or expended for the purpose of acquiring the income".

Counsel for the Applicant, in the course of his address, stated that these payments were made for the purpose of pleasing the employees and preserving the good will of the Company. In his submission the payments were made in connection with the acquiring of the income because if the employees were allowed to leave the company with bitter feelings they could have seriously interfered with the existing policy holders whom they had enlisted themselves and with whom they were in very close contact. Furthermore, he argued, although no such plans were made, there was nothing to prevent the Company from renewing cooperation with its ex agents if it should decide to start business again. In his submission, therefore, the payments were deductible expenses for income tax purposes.

For the Respondents it was contended that the nature of these payments could not refer to any future benefits to the trade of the Company nor were they expenses incurred in connection with the performance of the duties of the officers whose

services were terminated. It was submitted that the Commissioner was right in deciding that the payments were not incurred wholly and exclusively for the production of the Company's income.

In the course of his argument learned Counsel for the Applicant cited five cases, to which I will refer briefly. The first case cited is that of *Smith* v. *Incorporated Council of Law Reporting*, 83 L.J. K.B. p. 1721.

In that case the Respondents paid the sum of £1,500 as a retiring gratuity to one of their reporters who had served with them for 36 years. They had no pension or superannuation funds in connection with the retirement of members of their reporting staff, nor had such members any legal claim to pension or superannuation allowance. The appointment of the reporters was from year to year and it was in no way a part of their contract of service that a reporter would be entitled to receive a retiring gruatuity. But it had been the habit of the Respondents to give a gratuitous pension or to make a gratuity of a lump sum on retirement to a reporter after long service.

The question was whether this payment was allowable as a deduction in calculating the profits of the Council for income tax purposes. The Commissioners found for the Respondents. The court of Appeal upheld the decision of the Commissioners as this was a question of fact and there was evidence on which the Commissioners could decide it. The ground for the decision was that the employees expected to receive a gratuity on retirement, and, therefore, were likely to serve for somewhat smaller salaries than would otherwise be payable. This clearly appears from a passage in the judgment of Scrutton J. (at p. 1726) where he says:

> "The only remaining question is: was there evidence on which they could find that? What they find is that though the reporters have no legal right to a payment on retirement, it has been the habit of the Respondents to give a pension or to make a gratuity of a lump sum on retirement to a reporter after long service. One cannot help using ones ordinary knowledge of human nature to know that in some cases the expectation of gratuities may materially affect the amount of salary. If I may compare a very small and insignificant profession with a very dignified one; waiters, to the common knowledge, take much less salary because of the gratuities they expect to receive,

and when the Commissioners have found that it is the habit of these employers to give their reporters gratuitous pensions or gratuities of lump sums, I cannot help seeing that there is evidence upon which the Commissioners might find that those payments were made in the way of their trade because they may, at any rate, affect the amount of salary which they pay to their reporters".

In *Hancock* v. *General Reversionary and Investment Co.* 88 L.J. K.B. p. 248 the Court of Appeal held that the cost of purchasing an annuity for a retired employee, in substitution to his pension was an allowable deduction for income tax purposes. The employee in question, a Mr. Bumstead, had been in the service of the Respondents for very many years rendering them very valuable services. When he retired in 1905 the Respondents following their usual practice in such cases, awarded him a pension the amount of which was £666.13.4d. After his retirement he became a consultant actuary to the Respondents and later he became a director. In 1912 the Respondents entered into an agreement with the Clerical, Medical and General Life Insurance Society, whereby the latter acquired the bulk of the Respondents share capital. No provision was made with regard to Mr. Bumstead's pension. In 1913 the pension was commuted by the purchase by the respondents for £4,994 of an annuity for Mr. Bumstead's benefit in the Clerical, Medical and General Life Insurance Society to an equivalent amount. The pension, so long as it was paid, was always treated by the Respondents as a business expense and deducted from profits as such, and this deduction had been allowed. When the annuity was purchased the Respondents claimed to treat the £4,994 in the same way, but the surveyor disallowed the deduction. Lush J. in the course of his judgment had this to say on this point:

"I think that it necessarily follows, on the facts found by the Commissioners, that the £4,994 should be treated as the pension was treated, as an ordinary business expense, and that the deduction should be allowed. It is the pension in another form; it is actuarially equivalent in value and it is identical in character. It was paid to meet a continuing demand, which was itself an ordinary business expense, as the surveyor had treated it ..... It seems to me as impossible to hold that the fact that a lump sum was paid, instead of a recurring series of annual payments, alters the character of the expenditure as it

would be to hold that if an employer were under a voluntary arrangement with his servant to pay the servant a year's salary in advance, instead of paying a year's salary as it fell due, he would be making a capital outlay".

The next case cited by Counsel for the Applicant is that of *Mitchell* v. *B. W. Noble Ltd.*, 96 L.J. K.B. p. 484.

It was held by the Court of Appeal in that case that a lump sum, which had been paid to a director to secure the resignation of his directorship, was a deductible item because it was made to preserve the reputation of the Company, and to avoid what might have been undesirable publicity if legal proceedings between the company and the director had taken place. The director in question was a life director and the allegation of his colleagues was that he had been guilty of misconduct which would entitle the company to dismiss him forthwith under a clause of an agreement by the members of the company; but as the other directors were anxious that the matter should not become public, and that a scandal affecting the reputation of the company should be avoided they entered into negotiations with this director for his retirement and ultimately terms were agreed upno. By the agreement reached the other directors bought the shares of this director in the company and in addition the company paid to him the sum of £19,200 by instalments.

The Decision of the Court was based on the ground that this was a payment made in the course of business, with reference to a particular difficulty which arose in the course of the year, and was made not in order to secure an actual asset to the company, but to enable the company to continue to carry on as it had done in the past the same type and high quality of business unfettered and unimperilled by the presence of one who, if the public had known about it, might have caused difficulty in its business and with whom it was necessary to deal and settle at once.

In Anglo-Persian Oil Co. v. *Dale* 100 L.J. K.B. p. 504, the facts were briefly as follows:

The company had a contract with another company for the latter to act as its agent on commission basis. In the course of time the amounts of commission became far larger than was contemplated by the appellant company, and after negotiations the agency agreements were cancelled on the terms that the appellant company paid to the agent company £300,000. Having paid that sum the appellant company claimed to be

entitled to deduct it in computing its profit of the period in which the sum was paid and it was held by the Court of Appeal that the company was entitled to do so.

As in *Hancock* v. *General Reversionary and Investment Co.* the ground of the judgment was that the payment made was a payment to get rid of the liability for other payments which were themselves revenue payments, and that, therefore, the lump sum payment had the same character as those other payments.

The last case to which reference was made by Counsel for the appellant was *Godden* (*H.M. Inspector of Taxes*) v. *A. Wilson's Stores* (*Holdings*) *Ltd.* 40 Tax Cases p. 161. The Respondent company's trade was rubber planting. On March 16, 1958, the company agreed to sell its rubber estates, and completion of the sale took place on March 31, 1958, on which date the company's trade was discontinued. The company's manager had served the company in that capacity since 1946, and under the terms of his service with the company at the relevant time his services were terminable by six months' notice to be given on March 31st, or September 30th, in any year. On February 27, 1958, the company wrote to the manager giving him formal notice terminating his employment on March 31st and informing him that the company would pay him a sum of £1,900 "being six months' remuneration in lieu of notice as under your agreement you are entitled to full remuneration up to the 30th September, 1958".

The company included the sum of £1,900 in its trading expenses for the period ending March 31st, 1958, and the question at issue was whether that sum was a disbursement or expense wholly and exclusively laid out or expended for the purposes of the trade. It was held by the Court of Appeal, upholding the decision of Plowman J., that the payment of £1,900 was not made for the purpose of enabling the company to carry on its trade and earn profits and it was not, therefore, an allowable deduction in computing the company's profits for income tax purposes.

In *Commissioners of Inland Revenue* v. *Anglo-Brewing Company Ltd.*, 12 Tax Cases p. 803 a case cited by Counsel for the Respondent, the disputed payments were made to employees of the company upon the closing down of its business. It was held that the payments were not admissible deductions in computing the company's trading profits partly on the ground that, as

in the *Godden* case, the payments were not made for the purpose of carrying on the company's trade.

Another case cited by Counsel for the Respondent was *Strong and Company of Romsey, Ltd.* v. *Woodifield,* 5 Tax Cases, p. 215. The appellant company, a brewing company which also owned licensed houses in which they carried on the business of innkeepers incurred damages and costs to the amount of £1,490 on account of injuries caused to a guest staying at one of their houses by the falling of a chimney upon him; the fall of the chimney was due to the negligence of the appellant's servants whose duty it was to see that the premises were in proper condition. It was held that the damages and costs paid were not deductible for income tax purposes as they were unconnected with the trade. Lord Davey in the course of his Opinion (at p. 220) says:

> "I think that the payment of these damages was not money expended 'for the purpose of the trade'. These words are used in other rules, and appear to me to mean for the purpose of enabling a person to carry on and earn profits in the trade, etc. I think the disbursements permitted are such as are made for that purpose. It is not enough that the disbursement is made in the course of, or arises out of, or is connected with, the trade or is made out of the profits of the trade. It must be made for the purpose of earning the profits".

It clearly appears from the above cases that for a payment to qualify as a deductible expense for income tax purposes it must be a payment connected with the trade or business carried on *and* made in order to enable the tax-payer the better to carry on his trade or business for the purpose of earning the income, whether by getting rid of onerous service agreements or for the purpose of maintaining a high standard of business.

This seems to be in complete accord with the provisions of sections 11 and 13(e) of our Law above quoted.

It is, therefore, pertinent to consider the object of the disputed payments in the present case. Can it be said that the sole object with which the Applicant made the payments was to enable the Company to continue to carry on and acquire income in its business? Having regard to all the circumstances I think that the answer must be in the negative. I cannot accept the submission made on behalf of the Applicant that the payments

were made in order to avert any danger of interference with their existing policy holders by their ex agents or to enable the Company, if at some future time it decided to resume business in Cyprus, to renew its co-operation with its ex agents. Such view is, to my mind, too far fetched, especially in view of the fact that the payments were not made in consideration of any undertaking on behalf of the agents not to accept employment with any other firm transacting life insurance business in Cyprus.

It seems to me that these payments, which were incidental to the decision to discontinue new insurance business in Cyprus, were made for the purpose of enabling the Company to give effect to this decision without causing hardship to its agents. Such payments cannot, in my view, be said to have been made wholly and exclusively for the purpose of enabling the Company to carry on its business and earn income but rather for the purpose of enabling it to restrict its business.

In the circumstances I think that it was open to the Commissioner to come to the conclusion that the payments in question are not allowable deductions for income tax purposes and, therefore, I cannot interfere with such decision.

In the result this recourse fails and is hereby dismissed with costs, which I assess at £15.

Application dismissed with £15.– *costs.*