IN THE MATTER OF ARTICLE 146 OF THE CONSTITUTION

CHRIST. HAGGIPAVLU & SONS

Applicant,

and

THE REPUBLIC OF CYPRUS, THROUGH THE DIRECTOR OF THE INLAND REVENUE DEPARTMENT OF THE MINISTRY OF FINANCE,

Respondent.

(*Case No.* 159/66).

Income Tax—Deductions in computing profits—Deductible expenses—Expenditure on funeral of the Chairman of the Board of Directors of a Company—Not deductible in computing the taxable income of the Company—Interest charged in relation to a debt due to the Applicant Company by one of its Directors—Interest alleged to have been charged without a legal right to do so—Allegation not upheld—Therefore, the amount of such interest was rightly included in the taxable income of the Applicant Company—Shortages in the cash and stock of the Applicant Company's Nicosia Branch under the control of one of its Directors—Whether or not such deficit is deductible for income tax purposes—The Respondent's decision not to deduct it held to be erroneous—Because there was no evidence that the branch was under the exclusive control of the said Director, nor that the deficit in question was due to the fraudulent conduct and not to the negligence of the same Director—In the latter case the deficit would amount to a deductible trading loss—Curtis' *case,* infra, distinguished—«Ζημία» (*loss*) *in section* 15(1) *of the Personal Contributions by Members of the Greek Community Law,* 1963 (*Greek Communal Law No.* 9 *of* 1963), *means trading loss—Provisions of the said Law* 9/63 *re-enacted by the Personal Contributions by Members of the Greek Community Law,* 1964 (*Greek Communal Law No.* 7/64) *sections* 15(1) *and* 13(e) *of Law No.* 9/63, supra.

Income Tax—Deductible expenses—Deductibility of trading losses for which responsible is a Director of a Company—See above.

Personal Contributions—By member of the Greek Community—See above.

Greek Community—Members thereof—Personal contributions by such members—Greek Communal Laws Nos. 9/63 and 7/64, respectively—See above.

Words and Phrases—«Ζημία» (loss) in section 15(1) of the Greek Communal Law No. 9 of 1963—Means trading loss—See, also, above.

Administrative and Constitutional Law—Recourse under Article 146 of the Constitution—Decision contrary to law and in excess and abuse of powers—See, also, under Income Tax above.

Abuse and excess of powers—See above.

Excess and abuse of powers—See above.

Decision—Contrary to law and in excess and abuse of powers—See above.

Administrative decision—See immediately above.

Contract Law—Appropriation of payments—The Contract Law, Cap. 149, sections 59 to 61 same as sections 59 to 61 of the Indian Contract Act—Effect of—Principal debt and interest thereon—Payment in relation to such debt—Appropriation—In the absence of any specific appropriation by the debtor, the creditor is entitled to credit payments first against interest and then against the principal debt.

Interest—Appropriation—See immediately above.

In this case the Applicant complains, in effect, against the validity of a decision of the Respondent (who is, also, the Commissioner of Income Tax) by virtue of which he dismissed the objection of the Applicant against an assessment raised in relation to the year of assessment 1964, under the provisions of the Personal Contributions by Members of the Greek Community Law, 1964 (Greek Communal Law No. 7 of 1964), re-enacting the provisions of the Personal Contributions by Members of the Greek Community Law, 1963 (Greek Communal Law No. 9 of 1963). The grounds on which the Applicant had objected against the assessment in question are, also, the grounds on which this recourse has been based. They may be summarized as follows:

The Respondent wrongly refused to accept as deductible, in respect of the year 1963, the following three amounts:

(a) An amount of £315, being expenses for the funeral

of the late Chr Haggipavlu, the Chairman of the Board of Directors of the Applicant company for over sixty years,

(b) an amount of £1,138 claimed to represent interest charged by the Applicant, without a legal right to do so, in relation to a debt due to the Applicant by one of its Directors, C T ,

(c) an amount of £11,129 (plus a related amount of £100 legal fess) which represented part of shortages discovered to exist in 1963 in the cash and stock of the Nicosia branch of the Applicant company, in charge of which branch was the aforesaid Director C T

The three aforementioned amounts were claimed to be deductible by virtue of section 15 of the said Greek Communal Law No 9 of 1963 (re-enacted by Law No 7 of 1964, *supra*) Section 15(1) reads as follows "(1) Any loss incurred in the year preceding the year of assessment, in any commercial or industrial enterprise, trade or occupation, profession or any other vocation carried on by any person either solely or in partnership, may be set off to its whole extent against the income of such person from other sources for the same year of assessment"

(*Note* The Greek text of this sub-section is set out in the judgment, *post*)

It was argued by counsel for the Applicant, *inter alia* that section 15 (*supra*), unlike corresponding provisions of English Income Tax legislation does not render deductible *only trading losses, but all losses in general,* and that, therefore, the Applicant was entitled, in any case, to deduction of the amounts concerned for the purposes of the year of assessment 1964

Held, I As regards the meaning and effect of the word «Ζημία» (*"loss"*) *in section* 15(1) supra

(1) When one reads section 15(1) as a whole, and in the context of the Law in which it is to be found, there can be no doubt that what is meant to be conveyed by the notion of «Ζημία» ("loss") (*supra*) is a trading loss

(2) It should not be lost sight of that it is specifically provided in section 15(1) that the loss to be set off, under its provisions, is loss incurred *in the course of a commercial or industrial enterprise, trade or occupation, profession or any other vocation* I

cannot, therefore, find that the aforementioned submission by counsel for the Applicant (*supra*) can be upheld.

Held, II: As regards each one of the aforesaid three issues of deductibility:

(1) (a) Regarding the issue concerning the disbursement of £315, for the funeral expenses of the late Chairman of the Applicant company (*supra*), counsel for the Applicant has not put his case higher than this: Though it is not in the strict sense a trading expense, nevertheless, it is a disbursement which has been treated in the past as deductible, by way of established practice of the Income Tax Authorities in the United Kingdom; it is an accepted concession;

(b) No specific instances in Cyprus have been referred to so as to show that a similar practice has been established in Cyprus, too, and thus to lay, possibly, the foundation for a complaint by the Applicant that it has been discriminated against by means of the *sub judice* decision of the Respondent;

(c) On the other hand, counsel for the Respondent has referred the Court to section 13(e) of the said Greek Communal Law No. 9 of 1963 (*supra*) which seems to cover the matter in issue. (*Note:* section 13 (e) of that law reads as follows):

«πᾶσα δαπάνη ἢ ἔξοδον ὅπερ δέν ἀντιπροσωπεύει ποσὸν ἐξ ὁλοκλήρου καὶ ἀποκλειστικῶς διατεθὲν ἢ δαπανηθὲν πρὸς τὸν σκοπὸν κτήσεως τοῦ εἰσοδήματος».

(d) For all the above reasons, the Applicant's claim regarding the deduction from its income of the aforesaid amount of £315, being the funeral expenses for its late Chairman, fails and to that extent this recourse is dismissed.

2. Regarding the issue as to the amount of £1,138 which the Applicant seeks to deduct as being interest charged, but not lawfully due, in relation to an indebtedness to the Applicant company of one of its—at the time—Directors, the said C.T.:

(A) (a) It may be taken that, indeed, no written contract existed regarding the charging of interest in respect of the indebtedness concerned. But an oral agreement, express or implied, would suffice to render such a course a lawful one, and I am quite satisfied, on the material before me that such an agreement must have existed. This is, in my opinion, the only reasonable inference to be drawn from the conduct of the parties concerned; and in assuming, as it appears that he had done, the existence of such an agrement, the Respondent

has not acted in any way, under a misconception of fact which could vitiate its *sub judice* decision in this matter.

(b) There is, in the circumstances as disclosed by the evidence, no doubt at all in my mind that the interest in question was being charged rightfully, with full agreement of all concerned.

(B) (a) Furthermore, I agree with another contention of the Respondent in this matter, to the effect that the amount of £1,138 (*supra*) sought to be deducted from Applicant's income for the year 1963 cannot be regarded as being the interest charged —in relation to the relevant indebtedness of the said C.T.— from 1958 to 1962 as alleged by the Applicant, but it is an integral part of the balance of such indebtedness, namely of £1,404, which was still outstanding at the end of 1963.

(b) It is quite clear from the relevant provisions of our Contract Law, Cap. 149, sections 59 to 61 (which are the same as sections 59 to 61 of the Indian Contract Act, see Pollock and Mulla on the Indian Contract and Specific Relief Acts, 8th ed. p. 360 et seq.) that, if a debtor does not specifically appropriate a sum paid against an existing liability, it is up to the creditor to appropriate the sum accordingly, and in the case of a debt bearing interest payments are credited first against interest and then against the principal debt (see Pollock and Mulla *supra* at p. 364).

(c) In the present case, there being nothing to show that the debtor, the aforesaid C.T., when making payments against his indebtedness made any specific appropriation thereof, the Applicant, as it appears from the account (*exhibit* 1), quite properly applied such payments in the normal course of things against both the interest due and the principal debt; what remained was merely the balance of such debt.

(d) For all the above reasons I find that the Respondent was quite right in treating the amount of £1,138 (*supra*) as being part of the balance of a debt due to the Applicant which was not, in the circumstances, deductible for taxation purposes from the Applicant's income for the year 1963, year of assessment 1964. Therefore, this claim, too, of the Applicant fails, and to that extent this recourse is dismissed accordingly.

(3) Regarding the third and last issue concerning the claim of the Applicant to deduct from its income for 1963 the amount of £11,129, representing the balance of shortages in cash and

stock of the Nicosia Branch of the Applicant company, which were discovered in 1963:

(a) The Respondent disallowed the deduction. The reasons for doing so were that the person responsible for the deficit was the aforesaid C.T., who was one of the Directors of the Applicant company and who had absolute control regarding sales of the branch, and that the said deficit was not a trading loss.

(b) There is nothing before the Court which shows that the said C.T. was really responsible for the deficit in question. Moreover, it does not appear that he had absolute control regarding sales of the Nicosia Branch;

(c) But even assuming that the said C.T. was responsible for the whole deficit, there does remain the further question of whether or not there existed any material on which the conclusion could safely be reached that the said C.T. was so responsible through fraudulent conduct, and not merely through negligence in managing the affairs of the Nicosia Branch. And as at present advised, it seems to me that losses of a company due to the negligent mismanagement of its business by one or more of its Directors could be treated as being deductible in the process of ascertaining, for purposes of income tax, such company's gains or profits in that particular year.

(d) Reference has been made by counsel for the Respondent to the case of *Curtis* v. *J. and G. Oldfield Ltd.*, 9 Tax Cases, 319, at p. 330, per Rowlatt J. I do accept that this case lays down correctly the law, to the extent to which the law had to be applied to its particular facts. I do not think, however, that it can be read as excluding deductibility of trading losses where they occur through the negligence of one of the Directors of a company (*Note:* the passage from the Judgment of Rowlatt J. *supra* is fully set out post in the judgment of the Court). Likewise the cases *Roebank Printing Company Ltd.* v. *Commissioners of Inland Revenue*, 13 Tax Cases, 864; and *Pyne* v. *Stallard—Penoyre's Executor*, reported in the Accountants Journal, Vol. LVII (1965) p. 179, both referred to by counsel for the Respondent do not appear to carry the matter much further.

(e) In the present case we are faced, at this stage of the matter, with the position that the Respondent has decided the issue of deductibility of the balance of the aforesaid deficit of £11,129 rather prematurely and without the reasonably sufficient inquiry into all relevant aspects of the matter and particularly

into the exact role of the said Director C.T. in relation to the occurrence of the deficit concerned.

(f) In the circumstances the only proper course for me is to declare the *sub judice* decision of the Respondent, regarding the non-deductibility of the said balance of the deficit of the Nicosia branch of the Applicant company, null and void, as being contrary to law and in excess and abuse of powers; and the same applies necessarily to the collateral decision not to accept as deductible the £100 legal fess incurred by the Applicant in relation to the matter of such deficit.

(g) It is now up to the Respondent to reconsider the matter in question after full examination of all relevant aspects; and I have no doubt that Applicant will place no obstacles in the way of the Respondent when trying, as the proper administrative authority, to ascertain all material parts before deciding the matter finally.

Application succeeds in part as aforesaid. No order as to costs.

Cases referred to:

The Commissioner of Income Tax v. *Hagart* 14 Tax Cases, 433;

Curtis v. *J. and G. Oldfield Ltd.* 9 Tax Cases 319 at p. 330 Per Rowlatt, J., *distinguished;*

Roebank Printing Company Ltd. v. *Commissioners of Inland Revenue,* 13 Tax Cases 864;

Pyne v. *Stallard—Penoyre's Executor* (reported in the Accountants Journal, Vol. LVII (1965) p. 197.)

Recourse.

Recourse against the validity of a decision of the Respondent dismissing the objection of the Applicant against assessment of Income Tax raised in relation to the year of Assessment 1964, under the provisions of the Personal Contributions by Members of the Greek Community Law (Greek Communal Law 7/64).

Sir P. Cacoyiannis, for the Applicant.

G. Tornaritis; for the Respondent.

Cur. adv. vult.

The following Judgment was delivered by:

TRIANTAFYLLIDES, J.: In this Case the Applicant complains, in effect, against the validity of a decision of the Respondent (who is, too, the Commissioner of Income Tax) by virtue of which he dismissed the objection of the Applicant against an assessment raised in relation to the year of assessment 1964, under the provisions of the Personal Contributions by Members of the Greek Community Law (Greek Communal Law 7/64).

The said assessment is dated the 17th May, 1966, (see *exhibit* 10). The objection of the Applicant against it is dated the 27th May, 1966 (see *exhibit* 11) and the decision of Respondent dismissing the objection is to be found in a letter dated the 2nd June, 1966 (see *exhibit* 12); the final notice of assessment is of the same date (see *exhibit* 13).

The grounds on which the Applicant had objected against the assessment in question are, also, the grounds on which this recourse has been based; they are as follows:-

—That the Respondent refused to accept as a deductible expense in respect of the year 1963—(the income of which was taken as the basis for the assessment raised in relation to the year of assessment 1964)—an amount of £315, being the funeral expenses of the late Chr. Haggipavlu, who had been the Chairman of the Board of Directors of the Applicant for over sixty years.

—That the Respondent refused to accept as deductible, in respect of 1963, an amount of £1,138, which according to the allegation of the Applicant, represented interest charged, without a legal right to do so, in relation to a debt due to the Applicant by one of its Directors, Mr. Chr. Taveloudes.

—That the Respondent refused to accept as deductible, in respect of 1963, an amount of £11,129 (plus a related amount of £100 legal fess) which represented part of shortages discovered to exist in 1963 in the cash and stock of the Nicosia branch of the Applicant, of which in charge, at the time, was the said Mr. Taveloudes.

Though the assessment complained of was raised under the provisions of Greek Communal Law 7/64, in fact the provisions relevant to the present matter are the provisions of the Personal Contributions by Members of the Greek Community Law, 1963 (Greek Communal Law 9/63); such provisions were re-enacted by Greek Communal Law 7/64 for the purposes of the year of assessment 1964.

Counsel for the Applicant has stated that the three aforementioned amounts were claimed to be deductible by virtue of section 15 of Greek Communal Law 9/63.

Actually, in his final address, counsel for the Applicant went as far as to submit that section 15, unlike corresponding provisions of English income tax legislation, does not render deductible *only trading losses,* but *all losses* in general, and that, therefore, the Applicant was entitled. in any case, to deduction of the amounts concerned for the purposes of the 1964 assessment.

Section 15 reads, in its material part, as follows:–

«(1) Πᾶσα ζημία ἐπισυμβάσα ἐντὸς τοῦ ἔτους τοῦ προηγουμένου τοῦ φορολογικοῦ ἔτους ἐν ἐμπορικῇ ἢ βιομηχανικῇ ἐπιχειρήσει, ἐπιτηδεύματι ἢ βιοτεχνίᾳ, ἐλευθερίῳ ἢ ἄλλῳ τινὶ ἐπαγγέλματι ἀσκουμένῳ ὑφ' οἱουδήποτε προσώπου εἴτε ἀτομικῶς εἴτε ἑταιρικῶς, δύναται νὰ συμψηφισθῇ καθ' ὁλοκληρίαν μετὰ τοῦ ἐξ ἑτέρων πηγῶν εἰσοδήματος αὐτοῦ διὰ τὸ ἴδιον φορολογικὸν ἔτος».

("Any loss incurred, in the year preceding the year of assessment, in any commercial or industrial enterprise, trade or occupation, profession or any other vocation carried on by any person either solely or in partnership, may be set off to its whole extent against the income of such person from other sources for the same year of assessment").

In my opinion, when one reads section 15(1) as a whole, and in the context of the Law in which it is to be found, there can be no doubt that what is meant to be conveyed by the notion of «ζημία» ("loss") is a trading loss; it should not be lost sight of that it is specifically provided in section 15(1) that the loss to be set off, under its provisions, is loss incurred *in the course of a commercial or industrial enterprise, trade or occupation, profession or any other vocation.* I cannot, therefore, find that the aforementioned submission of counsel for Applicant can be upheld.

I pass on to deal, next, separately, with each of the three issues of deductibility which are involved in the present proceedings:–

Regarding the issue concerning the disbursement of £315.–, for the funeral expenses of the late Chairman of the Applicant,

Mr. Christodoulos Haggipavlu, counsel for the Applicant has not put his case higher than this: Though it is not in the strict sense a trading expense, nevertheless, it is a disbursement which has been treated in the past as deductible, by way of established practice of the Income Tax Authorities in the United Kingdom; it is an accepted concession.

No specific instances in Cyprus have been referred to so as to show that a similar practice has been established in Cyprus, too, and thus to lay, possibly, the foundation for a complaint by the Applicant that it has been discriminated against by means of the *sub judice* decision of the Respondent.

On the other hand, counsel for Respondent has referred the Court to section 13(e) of Greek Communal Law 9/63 which seems to cover the matter in issue.

In the circumstances, I am of the opinion that I cannot interfere on any proper ground with the action of the Respondent in not treating as a deductible expense the said amount of £315. To that extent, therefore, this recourse fails and is hereby dismissed accordingly.

I come next to the issue regarding the amount of £1,138.– which the Applicant seeks to deduct, as being interest charged, but not lawfully due, in relation to an indebtedness to the Applicant of one of its—at the time—Directors, Mr. Chr. Taveloudes.

The history of this indebtedness is, on the basis of the material before the Court, as follows:

There existed in Famagusta a limited company named D. D. Haggipavlu (Famagusta) Ltd., one of the shareholders of which was Mr. Taveloudes. The business of this company (to be hereinafter referred to as the "Famagusta company") was to buy from Applicant and resell in the town and district of Famagusta the products of the Applicant. When it was voluntarily wound up in 1958 it was owing money to the Applicant; at the same time there existed an indebtedness of Mr. Taveloudes to this Famagusta company amounting to £3,828,794 mils which arose out of an advance, as a loan, to Mr. Taveloudes.

It was agreed among all concerned to assign the claim of the Famagusta company against Mr. Taveloudes to the Applicant, as against the amount owed by such company to the Applicant.

So, as it appears in the relevant account of the Applicant

(see *exhibit* 1), on the 31st December, 1958, Mr. Taveloudes was debited as owing to the Applicant the aforesaid amount of £3,828.794 mils.

It may well be that the liability of the Famagusta company to the Applicant was in respect of goods delivered to it by the Applicant, but once Applicant accepted in part payment of such liability the indebtedness to the said company of Mr. Taveloudes, such indebtedness became a personal indebtedness of Mr. Taveloudes to the Applicant; and to that extent the indebtedness of the Famagusta company to the Applicant, in relation to goods delivered to it, had to be regarded as having been satisfied.

Thus, there could be no question of the indebtedness of Mr. Taveloudes to the Applicant—as assigned to it by the Famagusta company—being anything else than a personal liability of Mr. Taveloudes, payable on demand; and there having been, apparently, no demand made to Mr. Taveloudes by the Applicant to pay off his debt, it cannot be said that the Applicant's right to recover the amount due to it by Mr. Taveloudes became at any material time statute-barred, under the Limitation of Actions Law, Cap. 15.

As it appears from the relevant account (*exhibit* 1), as well as from the evidence of Mr. Costas Kyriakides the Chief Accountant of the Applicant, Mr. Taveloudes was being debited with interest at the rate of 7% per annum; such interest was capitalized at the end of each calendar year.

From this account it appears that interest was charged for every year from 1958 onwards, but no interest was charged in relation to 1963. In this respect it is useful to bear in mind that in 1963 shortages in the cash and the stock at the Nicosia branch of the Applicant, where Mr. Taveloudes was in charge —and with which I shall be dealing later on in this Judgment— were discovered, and it seems that as from that time onwards the operation of the debit account concerned ceased, presumably in anticipation of an overall regularization of the situation relating to Mr. Taveloudes, who ceased in 1963 to be a Director of the Applicant.

During the period between 1958 and 1963 Mr. Taveloudes paid against his indebtedness in question an amount of £3,563,080 mils and on the 31st December, 1963, there was still due by him a balance of £1,404.078 mils. Out of this balance, an amount of £1,138.– appears in the "interest account" of the

1963 accounts of the Applicant (see *exhibit* 15, Table 10) as interest previously charged (from 1958 to 1962) but written off, and the rest, £265.714 mils, appears as, also, written off in the "profit and loss account" of the 1963 accounts (see again *exhibit* 15).

The Respondent did not accept the amount of £265.714 mils as being deductible (see *exhibit* 8), and the Applicant did not object against the Respondent's decision regarding such amount and has not included this decision among the matters complained of by this recourse.

Originally, as it appears from the concluding entry in the relevant account (*exhibit* 1), the whole amount of £1,404.078 mils was treated as transferred, at the end of 1963, to the profit and loss account for that year, on the ground of insolvency of Mr. Teveloudes («Κέρδος & Ζημίαι: Μεταφ. Λογ. ἀναξ.»).

Later on, however, it seems that Applicant realized that the said amount could not be treated as a bad debt arising in the course of business; and, indeed, in the light, *inter alia,* of *The Commissioners of Income Tax* v. *Hagart* (14 Tax Cases, p. 433), this could not be so because of the circumstances in which the indebtedness in question of Mr. Taveloudes to Applicant arose in 1958, namely, through an assignment to Applicant, by the aforementioned Famagusta company, of a liability of Mr. Taveloudes, created by way of advancing to him a loan by such company.

Thus, in its objection to the assessment concerned in this Case (see *exhibit* 11), the Applicant has chosen to claim, only, that out of the amount of £1,104.078 mils an amount of £1,138 was deductible from its chargeable income in 1963, on the ground that it was the total of interest charged unlawfully over the years in relation to the relevant debit account of Mr. Taveloudes, there being, allegedly, no agreement between the parties for the payment of such interest by Mr. Taveloudes; therefore, according to the contention of the Applicant, this amount of £1,138 was not ever recovered and had to be written off.

I do not think that it is necessary to decide whether such amount could be treated as being deductible on the ground resorted to, as aforesaid, by the Applicant, because I am of the view, on the material before me, that such ground is, for the reasons that follow, not well-founded in the light of the true legal and factual situation pertaining to this matter:

It is correct that counsel for Respondent has conceded, at the hearing, that no written contract existed between Mr. Taveloudes and the Applicant regarding the payment of interest in relation to the indebtedness in question.

Earlier, in his letter of the 2nd June, 1966 (see *exhibit* 12) Mr. Zevlaris, a Principal Assessor acting for the Respondent, had stated that the interest on the said indebtedness had been charged by virtue of a contract; but when giving evidence before me Mr. Zevlaris admitted that he had not himself personally seen any contract for the purpose.

It may, therefore, be taken that, indeed, no written contract existed regarding the charging of interest in respect of the indebtedness concerned.

But an oral agreement, express or implied, would suffice to render such a course a lawful one, and I am quite satisfied, on the material before me, that such an agreement must have existed. This is, in my opinion, the only reasonable inference to be drawn from the conduct of the parties concerned; and in assuming, as it appears that he had done, the existence of such an agreement, the Respondent has not acted, in any way, under a misconception of fact which could vitiate its *sub judice* decision on this matter.

It is an admitted fact that the Applicant was actually charging interest, at 7% per annum, in the relevant debit account (*exhibit* 1) of Mr. Taveloudes.

Further, the Applicant was annually declaring the amount of such interest as being part of its taxable income (see the evidence of both Mr. Kyriakides and Mr. Zevlaris).

On the other hand, Mr. Taveloudes, himself, was declaring yearly to Respondent the interest with which he was being debited as aforesaid. Moreover, he declared such interest also in respect of the year 1957, when he still owed the loan concerned to the Famagusta company which assigned it in 1958 to the Applicant (see the evidence of Mr. Zevlaris); and it might be added, while on this point, that there is nothing to show, and it has not been alleged, that the indebtedness of Mr. Taveloudes to the Famagusta company was assigned to the Applicant under different terms.

Mr. Taveloudes was until 1963 a Director of the Applicant. He had full access to all its accounts, including the account

in respect of his own liability, (*exhibit* 1);and there can be no doubt that, as he was making payments regularly as against his liability, he must, at some stage during the five years between 1958 and 1963, have had occasion to inquire to find out what was the balance still due by him, and he must, thus, have discovered that his account was being debited with interest; then, no doubt, he would have put the matter right, by requesting that all interest charged should be deducted, if in fact it was being charged without lawful cause. Nothing of the sort appears to have happened, but on the contrary he must have more than once obtained from that account the exact figure of the interest charged therein, in order to declare it, as aforestated, to the Respondent.

The evidence adduced by the Applicant in this Case, in order to disprove the existence of an agreement for the payment of interest by Mr. Taveloudes, was only of a negative, inconclusive and unreliable nature, because the witness who gave such evidence—Mr. Kyriakides—could only say that he did not trace any agreement in the records of the Applicant about payment of interest by Mr. Taveloudes, nor did he come to hear of such an agreement; yet, this very witness admitted charging Mr. Taveloudes with 7% interest per annum in the relevant account (*exhibit* 1) and he could not have done so unless he had been given to understand, by word or conduct, by those concerned, that this should have been so.

There is, in the circumstances, no doubt at all in my mind that the interest in question was charged rightfully, with full agreement of all concerned.

Furthermore, I agree with another contention of Respondent in this matter, to the effect that the amount of £1,138 sought to be deducted from Applicant's income for 1963 cannot be regarded as being the interest charged—in relation to the relevant indebtedness of Mr. Taveloudes—from 1958 to 1962, but it is an integral part of the balance of such indebtedness, namely £1,404.078 mils, which was still outstanding at the end of 1963.

Respondent's view on the point is fully in accordance with the legal principles governing appropriation of payments, as they are to be found in sections 59 to 61 of the Contract Law, Cap. 149. Our said provisions are the same as sections 59 to 61 of the Indian Contract Act (see Pollock and Mulla on the Indian Contract and Specific Relief Acts, 8th ed. p. 360

et. seq.). It is quite clear from the relevant provisions that, if a debtor does not specifically appropriate a sum paid against an existing liability, it is up to the creditor to appropriate the sum accordingly, and in the case of a debt bearing interest payments are credited first against interest and then against the principal debt (see Pollock and Mulla, *supra* at p. 364). In the present Case, there being nothing to show that Mr. Taveloudes when making payments against his indebtedness made any specific appropriation thereof, the Applicant, as it appears from the account (*exhibit* 1), quite properly applied such payments, in the normal course of things, against both the interest due and the principal debt; what remained was the balance of such debt.

For all the foregoing reasons I find that the Respondent was quite right in treating the amount of £1,138 as being part of the balance of a debt due to the Applicant which was, in the circumstances, not deductible for taxation purposes from the income of the Applicant for 1963; therefore, this claim, too, of the Applicant fails, and to that extent this recourse is dismissed accordingly.

I come now to deal with the third and last issue involved in this Case: it concerns the claim of the Applicant to deduct fro mits income for 1963 an amount of £11,129.518 mils, representing the balance of shortages in cash and stock of the Nicosia branch of the Applicant, which were discovered in 1963.

The history of relevant events is as follows:

On the 4th January, 1951, the Board of Directors of the Applicant decided to appoint Mr. Taveloudes, one of them, as the Manager of the Nicosia branch. He would be remunerated by means of a salary, plus commission, and all expenses of the branch would be borne by the Applicant (see the minutes *exhibit* 4).

As a result, a letter was addressed to Mr. Taveloudes on the 19th January, 1951 (see *exhibit* 2) and he accepted the appointment in question by letter dated the 25th January, 1951 (see *exhibit* 3).

According to the evidence of Mr. Kyriakides—the Chief Accountant of the Applicant—the checking of the accounts of the Nicosia branch was not very regular; eventually in 1963, after a thorough investigation, it was discovered, as it is shown

in the relevant statement of account (*exhibit* 16), that there existed, in June 1963, severe shortages in the cash and in the stock of the branch. The total deficit thus brought to light amounted to £17,226.018 mils.

Against this Mr. Taveloudes paid £6,096.500 mils, by tranferring to the Applicant 12,193 shares in another company; according to the evidence of Mr. Kyriakides after this transaction Mr. Taveloudes was left with no other property.

The resulting balance of the deficit, £11,129.518 mils, was transferred to the "profit and loss account" of the Applicant for 1963 (see *exhibit* 15).

The Respondent disallowed the deduction of this amount for income tax purposes. The reasons for doing so are to be found in the letter of the 17th May, 1966, which must be read together with the decision of the Respondent (see *exhibit* 12) rejecting the objection of the Applicant against the assessment for the year 1964. The said reasons are that the person responsible for the deficit was Mr. Taveloudes, who was one of the Directors of the Applicant and who had absolute control regarding sales of the branch, and that the said deficit was not a trading debt.

I have reached the conclusion, on the material at present before the Court, that the main premises on which the Respondent reached his *sub judice* decision were rather premature assumptions, reached without sufficient inquiry; and, thus, there also arises a strong probability that the Respondent has acted on the basis of material misconceptions.

There is nothing before the Court which shows that Mr. Taveloudes was really responsible for the deficit in question.

Moreover, it does not appear that he had absolute control regarding sales of the Nicosia branch. According to the evidence of Mr. Kyriakides, those effecting sales were the cashier of the Nicosia branch and the salesmen—who were two or three; and those effecting the sales were also collecting the money in respect thereof. Also, the Nicosia branch had a central store for which a store-keeper was responsible, and there was a retail sales store, next to the office of the branch, for which another employee was responsible; this employee had access to the central store, too.

Neither before nor after this evidence was given, did the

Respondent put before the Court any material on the basis of which the conclusions had been reached by him regarding the responsibility of Mr. Taveloudes for the deficit and that Mr. Taveloudes had absolute control regarding sales; I have to presume, thus, for the purpose of determining this Case, that no such material was in the possession of Respondent; otherwise it would surely have been placed before the Court; in particular such material would have been put to Mr. Kyriakides who in his evidence appeared to attribute at least part of the deficit to other causes such as evaporation, leakages, breakages, etc. which are usual in the wines and spirits trade.

But even assuming that Mr. Taveloudes was responsible for the whole of the deficit, there does remain the further question of whether or not there existed any material on which the conclusion could safely be reached that Mr. Taveloudes was so responsible through fraudulent conduct, and not merely through negligence in managing the affairs of the Nicosia branch.

It is quite correct that the payment, as aforesaid, by Mr. Taveloudes of £6,096.500 mils, as against the deficit of the Nicosia branch, does show that he admitted being responsible therefor to a considerable extent, but there is nothing to show that he admitted thereby responsibility for fraud, and not only for negligence.

If through the negligent mismanagement of a company's business, by one or more of its Directors, it suffers trading losses in a particular year, it appears to me, as at present advised, that such losses could be treated as being deductible in the process of ascertaining, for purposes of income tax, such company's gains or profits in that particular year.

Reference has been made by counsel for Respondent to the case of *Curtis* v. *J. & G. Oldfield Ltd.* (9 Tax Cases, p. 319). In that case it was found, on the death of the Managing Director of a company, that his estate owed to the company £14,000, due to the fact that many payments and some receipts not relating to the company's business, but to his private affairs, had been passed through the company's books. The debt was valueless and was written off. In holding that such debt was not a deductible bad debt Rowlatt J. had this to say (at p. 330):

> "When the Rule speaks of a bad debt it means a debt which is a debt that would have come into the balance sheet as a trading debt in the trade that is in question and that

it is bad. It does not really mean any bad debt which, when it was a good debt, would not have come in to swell the profits. What the Commissioners have been misled by, in my judgment, quite clearly is this. They have allowed themselves to act under the impression that they were taxing the Company on what the Company in a loose way had made and secured. In point of law they were engaged in assessing the profits of the Company's trade, not of the Company itself but of the Company's trade, and I have to consider whether there is the least ground for supposing that losses of these sums resulting in this bad debt were losses in the trade. I quite think, with Mr. Latter, that if you have a business (which for the purposes of to-day at any rate I will assume) in the course of which you have to employ subordinates, and owing to the negligence or the dishonesty of the subordinates some of the receipts of the business do not find their way into the till, or some of the bills are not collected at all, or something of that sort, that may be an expense connected with and arising out of the trade in the most complete sense of the word. But here that is not his case at all. This gentleman was the Managing Director of the Company, and he was in charge of the whole thing, and all we know is that in the books of the Company which do exist it is found that moneys went through the books into his pocket. I do not see that there is any evidence at all that there was a loss in the trade in that respect. It simply means that the assets of the Company, moneys which the Company had got and which had got home to the Company, got into the control of the Managing Director of the Company, and he took them out. It seems to me that what has happened is that he has made away with receipts of the Company dehors the trade altogether in virtue of his position as Managing Director in the office and being in a position to do exactly what he likes".

That case I do accept as laying down the law correctly, to the extent to which the law had to be applied to its particular facts. I do not think, however, that it can be read as excluding deductibility of trading losses where they occur through the negligence of one of the Directors of a company.

Likewise the cases of *Roebank Printing Company Ltd.* v. *Commissioner of Inland Revenue* (13 Tax Cases, p. 864) and of *Pyne* v. *Stallard-Penoyre's Executor,* (reported in The Ac-

countants Journal, Vol. LVII (1965), p. 179), which were referred to by counsel for Respondent, do not appear to carry the matter much further in so far as the task of applying the law to the facts of the *sub judice* Case is concerned.

In the present Case we are faced, at this stage of the matter, with the position that, as already indicated, the Respondent has decided the issue of deductibility of the balance of the deficit of the Nicosia branch—£11,129.518 mils—rather prematurely and without the reasonably sufficient inquiry into all relevant aspects of the matter and particularly into the exact role of Mr. Taveloudes in relation to the occurrence of the deficit concerned. It does appear to me that the Respondent was somewhat carried away by the wording of the Judgment in the *Curtis* case (*supra*) and, so, once Mr. Taveloudes, a Director, was managing the Nicosia branch, it was thought that the *Curtis* case led to the *sub judice* decision of Respondent as a matter of law, without more ado as to the facts.

This clearly was not a case in which the tax-payer concerned, the Applicant, had refused to produce accounts or give information, so as to force the Respondent to act on estimate and without being able to conduct a full inquiry ; on the contrary there appears to have been close contact with Applicant in the matter.

In the circumstances, I have reached the conclusion that the only proper course for me is to declare the *sub judice* decision of the Respondent, regarding the non-deductibility of the balance of the deficit of the Nicosia branch of Applicant, null and void and of no effect whatsoever, being contrary to law and in excess and abuse of powers; and the same applies necessarily to the collateral decision not to accept as deductible the £100 legal fees incurred by the Applicant in relation to the matter of such deficit. Therefore, this recourse succeeds to that extent only, having otherwise failed, as already stated.

It is now up to the Respondent to reconsider the matter in question after full examination of all relevant aspects; and I have no doubt that Applicant will place no obstacles in the way of the Respondent when trying, as the proper administrative authority, to ascertain correctly all material facts before deciding the matter finally.

Regarding costs and bearing in mind that Applicant has only been successful in part in this recourse ! have decided to make no order as to costs.

Application succeeds in part.
No order as to costs.