1979 May 29

[TRIANTAFYLLIDES, P., STAVRINIDES, L. LOIZOU, HADJIANASTASSIOU, JJ.]

PANOS LANITIS AND SONS (INVESTMENTS) LTD.,
Appellant,

v.

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

(*Revisional Jurisdiction Appeal No.* 130).

Income Tax—Interest—Deduction—Private company—Carrying on business of investment and deriving its income from rents and dividends received from investments—Interest paid by the company on a loan incurred for purchase of shares in a public company—Whether an allowable deduction—A question depending on circumstances of each case—Decision to treat interest, paid as above, as non-deductible not reached as a result of the consideration of the individual circumstances of this case but because instructions in a relevant circular of the Commissioner were treated as an inflexible rule and applicable in all cases of interest paid on money borrowed as above—Annulled—Sections 11(1) *and* 13(e) *of the Income Tax Laws* 1961 *to* 1976.

The appellant company, a private company having its registered office in Limassol ("the company") was incorporated in 1953 for the purpose of carrying on the business of investment and it derived its income from rents and dividends received from investments in shares of other companies. In assessing the income tax payable by the company for the year of assessment 1971 the respondent Commissioner refused to treat as allowable deduction the amount of interest paid by the company on a loan incurred for the purchase of shares in a public company. In adopting this course the Commissioner departed from his previous practice, which was to the contrary effect, and acted on the basis of a circular* which he issued on September 10, 1969. The

* The relevant text of the circular is quoted at p. 51 *post.*

company challenged the above decision by means of a recourse which was dismissed and hence this appeal.

Under section 11(1) of the Income Tax Laws 1961 to 1976, which were in force at the material time, there had to be deducted for the purpose of ascertaining the chargeable income of the appellant all outgoings and expenses wholly and exclusively incurred by it in the production of its income, and under section 13(e) of the same Laws any disbursements or expenses not being money wholly and exclusively laid out or expended for the purpose of acquiring the income should not be treated as an allowed deduction.

Held, (1) that though it is a question of fact in each particular case whether or not the borrowing of money is an incident in the course of carrying on the business of a company, in which case the interest paid thereon is an outgoing incurred for the purpose of earning its income and as such is deductible in ascertaining its chargeable income for the purposes of income tax, the *sub judice* decision of the respondent Commissioner was not reached as a result of the consideration of the individual facts pertaining to the particular instance of the borrowing of money by the appellant for the purpose of purchasing shares in a public company, namely the Cyprus Popular Bank Limited, but because the instructions contained in the aforementioned circular dated September 10, 1969, were treated as an inflexible rule applicable in each and every case of interest paid on money borrowed for the purpose of acquiring shares in a public company.

(2) That such a course of action was contrary to the relevant legislative provisions because these provisions must be properly applied in respect of interest paid or payable in relation to money borrowed for the purchase of shares in a company irrespective of whether or not, in any particular instance, the company concerned is a private or a public one; that, consequently, the *sub judice* decision of the respondent Commissioner has to be annulled; and that, accordingly, the appeal must be allowed and the matter be considered afresh by the Commissioner.

Appeal allowed.

Cases referred to:

Pikis v. *The Republic* (1965) 3 C.L.R. 131 at p. 149;
Philokyprou v. *The Republic* (1966) 3 C.L.R. 327 at p. 336;
Karnaou v. *The Republic* (1966) 3 C.L.R. 757 at p. 764.

Appeal.

Appeal from the judgment of a Judge of the Supreme Court of Cyprus (A. Loizou, J.) given on the 15th December, 1973 (Revisional Jurisdiction Case No. 417/71) whereby appellant's recourse, against the refusal of the respondent Commissioner of Income Tax to treat as an allowed deduction from the taxable amount of income of the appellant, in relation to the year of assessment 1971, the interest paid on an amount borrowed by appellant for the purpose of acquiring shares in a public company, was dismissed.

A. Triantafyllides, for the appellant.

A. Evangelou, Counsel of the Republic, for the respondents.

Cur. adv. vult.

TRIANTAFYLLIDES P. read the following judgment of the Court. By this appeal the appellant company challenges the decision* of a Judge of this Court by means of which there was dismissed its recourse against the refusal of the respondent Commissioner of Income Tax—who comes under the respondent Minister of Finance—to treat as an allowed deduction from the taxable income of the appellant, in relation to the year of assessment 1971, the interest paid on an amount borrowed by it for the purpose of acquiring shares in a public company.

The salient facts of this case, as found by the trial Judge, are briefly as follows:

The appellant company is a private company having its registered office in Limassol. It was incorporated in 1953 for the purpose of carrying on the business of investment and it derives its income from rents and dividends received from investments in shares of other companies. It has a share capital of 100,000 shares of £1 each.

In relation to the year of assessment 1971—year of income 1970—its revenue was £1,224 by way of rents and £13,318 by way of dividends.

The appellant submitted audited accounts showing a taxable income of £884; this amount was arrived at after deducting, *inter alia*, the sum of £8,098.485 mils, which was interest paid to the Cyprus Popular Bank Limited on a current account of the appellant with the said Bank.

* Reported in (1973) 3 C.L.R. 667.

The respondent Commissioner decided, however, that a sum of £4,053 represented interest paid by the appellant in 1970 in respect of an amount borrowed for the purpose of purchasing shares of the aforesaid Bank—which is a public company—as an investment and, as a result, the appellant was required to pay £1,722.525 mils income tax over and above what is stated in its relevant return, because the said interest was not an allowed deduction.

The decision of the respondent Commissioner on this matter was communicated to the accountants of the appellant by a letter dated April 7, 1971, the material part of which reads as follows:-

" (α) *Δάνεια πρὸς κτῆσιν μετοχῶν Δημοσίων Ἑταιρειῶν.*

Οἱ τόκοι ἐπὶ τῶν ἐν λόγῳ δανείων δὲν ἐκπίπτονται τῆς φορολογίας καθ' ὅτι δὲν θεωροῦνται ὡς δαπάνη ἐξ ὁλοκλήρου καὶ ἀποκλειστικῶς γενομένη πρὸς κτῆσιν τοῦ εἰσοδήματος. Ὡς ἐκ τούτου τὸ ἥμισυ τοῦ πληρωθέντων τόκων θὰ προστεθῇ εἰς τὸν προσδιορισμὸν ".

("(a) *Loans for the purchase of shares in Public Companies.*

The interest in respect of the said loans is not deductible for purposes of income tax as it is not considered to be an expense wholly and exclusively incurred in the production of such income. Therefore half of the interest paid shall be added to the assessment.")

The appellant, through its advocate, objected to the above decision, on April 26, 1971, and on October 4, 1971, the respondent Commissioner addressed a letter to the appellant, the material part of which reads as follows:-

"2. Ὡς ἤδη σᾶς ἐπληροφόρησα διὰ τῆς ὑπὸ ἡμερομηνίαν 7ης Ἀπριλίου, 1971, ἐπιστολῆς μου (παράγραφος Ι(α)) οἱ τόκοι ἐπὶ τῶν Δανείων πρὸς κτῆσιν μετοχῶν Δημοσίων Ἑταιρειῶν δὲν ἐκπίπτονται τοῦ εἰσοδήματος, καθ' ὅτι δὲν θεωροῦνται ὡς δαπάνη ἐξ ὁλοκλήρου καὶ ἀποκλειστικῶς γενομένη πρὸς κτῆσιν τοῦ εἰσοδήματος".

("2. As I have already informed you by my letter dated April 7, 1971 (paragraph I(a)) the interest on Loans for the purchase of shares in Public Companies is not deductible from income, because it is not considered to be an expense.

wholly and exclusively incurred in the production of the income").

As a result, the appellant filed a recourse under Article 146 against the complained of decision of the respondent Commissioner.

It is pertinent to state, at this stage, that on September 10, 1969, the respondent Commissioner sent a circular, No. 115, to all assessors in his Office, with copies to all authorised accountants, including the accountants of the appellant, the material parts of which read as follows:-

"*INTEREST PAID OR PAYABLE*

It has been our practice upto now to admit as a deductible expense payments of interest in respect of money borrowed for any purpose, although in accordance with the Law an expense is allowed only if it is incurred wholly and exclusively in the production of the income.

2. As from the year of assessment 1970 the concessional deduction in respect of payments of interest should be restricted only in respect of money borrowed for any of the purposes mentioned below:-

(a) .....

(b) The purchase of shares in a private company, or the lending of money to such company for use in its business where the borrower has a substantial holding in the company;

(c) .....

(d) .....

(e) .....".

According to section 11(1) of the Income Tax Laws, 1961 to 1976, which were in force at the material time, there had to be deducted for the purpose of ascertaining the chargeable income of the appellant all outgoings and expenses wholly and exclusively incurred by it in the production of its income, and under section 13(e) of the same Laws any disbursements or expenses not being money wholly and exclusively laid out or expended for the purpose of acquiring the income should not be treated as an allowed deduction.

We agree with the learned trial Judge that it is a question of fact in each particular case whether or not the borrowing of money is an incident in the course of carrying on the business of a company, in which case the interest paid thereon is an outgoing incurred for the purpose of earning its income and as such is deductible in ascertaining its chargeable income for the purposes of income tax.

Having examined the totality of the material before us we have reached the conclusion that the *sub judice* decision of the respondent Commissioner was not reached as a result of the consideration of the individual facts pertaining to the particular instance of the borrowing of money by the appellant for the purpose of purchasing shares in a public company, namely the Cyprus Popular Bank Limited, but because the instructions contained in the aforementioned circular dated September 10, 1969, were treated as an inflexible rule applicable in each and every case of interest paid on money borrowed for the purpose of acquiring shares in a public company.

Such a course of action is, in our opinion, contrary to the relevant legislative provisions, to which reference has already been made in this judgment, because these provisions must be properly applied in respect of interest paid or payable in relation to money borrowed for the purchase of shares in a company irrespective of whether or not, in any particular instance, the company concerned is a private or a public one.

Consequently, the *sub judice* decision of the respondent Commissioner has to be annulled and this appeal is allowed accordingly on this ground; the respondent has to consider afresh the matter and reach a new duly reasoned decision thereon which ought to be communicated in due course to the appellant.

Once this appeal has been allowed on the aforesaid ground we need not, and should not, deal with any other aspects of the matter; so, necessarily, anything stated in the appealed from judgment in relation to such aspects must be treated as being obiter and no longer binding on the parties as res judicata.

We ourselves do not pronounce, at this stage, in this connection in any way whatsoever and we leave all these other aspects of this case entirely open, because we ought not to anticipate or

forestall the action to be taken by the respondent Commissioner. As has been pointed out in, *inter alia*, *Pikis* v. *The Republic*, (1965) 3 C.L.R. 131, 149, it must not be lost sight of that it is for the Government to govern and for the Court only to control to the extent necessary, and, so, it is not up to this Court to determine in the first instance matters of administration before Government has itself dealt with such matters on their merits (and, see, also, *Philokyprou* v. *The Republic*, (1966) 3 C.L.R. 327, 336, and *Karnaou* v. *The Republic*, (1966) 3 C.L.R. 757, 764).

In the result, this appeal is allowed and the *sub judice* income tax assessment is annulled, but we do not propose to make any order as to the costs of this appeal or of the trial.

Appeal allowed. No order as to costs.