1984 February 13

[TRIANTAFYLLIDES, P., L. LOIZOU, HADJIANASTASSIOU, MALACHTOS, DEMETRIADES, SAVVIDES, JJ.]

IN THE MATTER OF ARTICLE 146 OF THE CONSTITUTION

PANOS LANITIS AND SONS (INVESTMENTS) LIMITED,
Applicants,

v.

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

(*Case No.* 14/80).

Income Tax—Interest—On money borrowed for the purpose of purchase of shares of a public company—Is not an allowable deduction for income tax purposes—Sections 11(1) *and* 13(*c*)(*e*)(*f*) *of the* ***Income Tax Laws,*** **1961-1973.**

Administrative Practice—Cannot defeat a tax liability—Concessionary policy of income tax authorities which was not consistent with the proper construction and application of the relevant legislative provisions—After it was discontinued the relevant legislation had to be applied on the basis of the particular facts of each individual case.

Constitutional Law—Equality—Discrimination—Fiscal and taxation matters—Legislative and administrative authorities of a State allowed considerable latitude in laying down policy in relation to—Existence of factors, which as a matter of taxation policy, appear to justify a differentiation as regards the treatment for purposes of deduction from taxable income of interest paid in respect of loans incurred for the purchase of shares in public companies and for the purchase of shares in private companies.

The applicants, a private company of limited liability, challenged assessments of income tax for the years of assessment 1972

and 1973 to the extent to which such assessments were based on a decision of the respondent Commissioner of Income Tax not to deduct from the taxable income of the applicants interest which was paid in respect of money borrowed by the applicants from the Cyprus Popular Bank Ltd. for the purpose of purchasing shares in such bank, which was a public company.

The respondent Commissioner decided* that the loan acquired was considered as capital; and that the interest therefor was an expense incurred in respect of acquisition of capital and therefore it was not an expense wholly and exclusively incurred in the production of income.

Up to the 10th September, 1969 the practice of the respondent Commissioner was 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 was allowed only if it was incurred wholly and exclusively in the production of the income; by virtue of a circular dated the 10th September, 1969 the above concessional deduction was restricted only in respect of money borrowed for the purchase of shares in a private company.

Held, it is a well settled principle of income tax law, which has, also, been given statutory effect both here and in England, that no deduction from taxable income is allowable in respect of capital employed or intended to be employed in a trade; and that interest of borrowed money, which is capital intended to be employed or is employed in trade, is not allowable as a deduction from taxable income; that, therefore, the sub judice decision of the respondent Commissioner was lawfully and reasonably open to him and once this is so this Court cannot interfere with it (see sections 11(1) and 13(c)(e)(f) of the Income Tax Laws, 1961–1973).

Held, further, (1) that administrative practice cannot defeat a tax liability; that in the present instance there had existed only a concessionary policy and after it was discontinued the relevant legislation had to be applied on the basis of the particular facts of each individual case (*P.M. Tseriotis Ltd.* v. *Republic* (1970) 3 C.L.R. 135 at p. 143 distinguished).

* The sub judice decision is quoted at pp. 1591–1592 post.

(2) That there do exist factors which, as a matter of taxation policy, appear to justify a differentiation as regards the treatment for purposes of deduction from taxable income of interest paid in respect of loans incurred for the purchase, on the one hand, of shares in public companies and for the purchase, on the other hand, of shares in private companies, in view of essential differences between public and private companies; and it must be borne in mind that both the legislative and the administrative authorities of a State are allowed considerable latitude in laying down policy in relation to fiscal and taxation matters.

Application dismissed.

Cases referred to:

Panos Lanitis and Sons (Investments) Ltd. v. *The Republic* (1973) 3 C.L.R. 667; and on appeal (1980) 3 C.L.R. 47;

European Investment Trust Co. Ltd. v. *Jackson (H.M. Inspector of Taxes)*, 18 T.C. 1 at p. 11;

Ascot Gas Water Heaters Ltd. v. *Duff (H.M. Inspector of Taxes)*, 24 T.C. 171 at pp. 175, 176;

Bridgwater v. *King (H.M. Inspector of Taxes)*, 25 T.C. 385 at p. 386;

Pattison (Inspector of Taxes) v. *Marine Midland Ltd.* [1982] *Ch.* 145 at p. 159-167;

P.M. Tseriotis Ltd. v. *Republic* (1970) 3 C.L.R. 135 at p. 143;

Antoniades v. *Republic* (1979) 3 C.L.R. 641;

Apostolou and Others v. *Republic* (1984) 3 C.L.R. 509.

Recourse.

Recourse against the income tax assessments raised on applicants for the years 1972 and 1973.

A. Triantafyllides, for the applicants.

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

Cur. adv. vult.

TRIANTAFYLLIDES P. read the following judgment of the Court. The applicants are a private company of limited liability and they challenge assessments of income tax for the years of assessment 1972 and 1973 to the extent to which such assessments were based on a decision of the respondent Commissioner of Income Tax not to deduct from the taxable income of the applicants interest which was paid in respect of money borrowed by the applicants from the Cyprus Popular Bank Ltd. for the purpose of purchasing shares in such bank, which is a public company.

It is useful to mention, at this stage, that previous litigation regarding the above issue, but in respect of the year of assessment 1971, turned out, eventually, to be inconclusive as regards the issue of whether or not interest paid as aforesaid was to be deducted from the taxable income of the applicants (see *Panos Lanitis and Sons (Investments) Limited* v. *The Republic*, (1973) 3 C.L.R. 667, and, on appeal *Panos Lanitis and Sons (Investments) Limited* v. *The Republic*, (1980) 3 C.L.R. 47).

The sub judice decision is to be found in a letter of the respondent Commissioner dated the 17th November 1979, which reads as follows:

> "I have reconsidered your case and according to the below mentioned facts and reasons, I have decided to raise a fresh assessment for the year of assessment 1971 as provided under section 21(3) of the Assessment and Collection of Taxes Laws 1978 to 1979 and further to determine the assessments for the years of assessment 1972 and 1973.
>
> (a) The loan contracted from the Popular Bank was to enable you to find capital to purchase the rights issue of shares in respect of shares of the said bank held by you as investments which are fixed assets. Therefore the loan acquired is considered as capital.
>
> (b) Capital is not a deductible expense from your chargeable income for income tax purpose and any expense incurred in acquisition of capital is not an allowable deduction as well.
>
> (c) The interest amounting to £4,053, £4,500 and £4,800 claimed in respect of the loan made from the Popular

Bank for the years 1970, 1971 and 1972 respectively is an expense incurred in respect of acquisition of capital and therefore it is not an expense wholly and exclusively incurred in the production of income".

The situation which has given rise to the present proceedings came about as a result of a circular (No. 115 and dated 10th September 1969) which the respondent Commissioner sent to all assessors in his office, with copies to all authorized accountants, including the accountants of the applicants, and 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) ———————————————————————".

It is a well settled principle of income tax law, which has, also, been given statutory effect both here and in England, that no deduction from taxable income is allowable in respect of capital employed or intended to be employed in a trade; and that interest on borrowed money, which is capital intended to be employed or is employed in trade, is not allowable as a deduction from taxable income (see, inter alia, Halsbury's

Laws of England, 4th ed., vol. 23, p. 211, para. 304, and Simon's Income Tax 1964–1965, vol. 2, pp. 398, 399, para. 620).

The above principle was expounded in, inter alia, *The European Investment Trust Company, Limited* v. *Jackson* (*H.M. Inspector of Taxes*), 18. T.C. 1, 11, which was followed and applied in *Ascot Gas Water Heaters Ltd.* v. *Duff* (*H.M. Inspector of Taxes*), 24 T.C. 171, 175, 176 and *Bridgwater* v. *King* (*H.M. Inspector of Taxes*), 25 T.C. 385, 388.

It is true that in Simon's Income Tax, supra, there is expressed the view (at p. 399) that the decision in *The European Investment Trust* case, supra, might not withstand challenge in future, but this forecast does not appear to have turned out to be a correct one because, very recently, in *Pattison* (*Inspector of Taxes*) v. *Marine Midland Ltd.*, [1982] Ch. 145, 159–167, *The European Investment Trust* case was again followed and applied.

On the basis of the facts of this case and of the reasoning which is set out in the above quoted letter of the respondent Commissioner, dated 17th November 1979, as well as in the light of the relevant principles of income tax law and of the provisions of our Income Tax Laws, 1961–1973 (particularly sections 11(1) and 13(c)(e)(f)) we find that the sub judice decision of the respondent Commissioner was lawfully and reasonably open to him and once this is so we cannot interfere with it (see, inter alia, *Georghiades* v. *The Republic*, (1982) 3 C.L.R. 659, 667–669).

It has been argued by counsel for the applicants that prior to the aforesaid circular No. 115 of 10th September 1969 interest in respect of money borrowed for the purchase of shares in both public and private companies was being treated as a deductible expense and that there had, thus, been established an administrative practice on which the applicants had relied since 1965; and that, consequently, such practice could not be altered to the detriment of the applicants. Reliance has been placed, in this respect, on *P.M. Tseriotis Ltd.* v. *The Republic*, (1970) 3 C.L.R. 135, 143.

The present case is, however, distinguishable from the *Tseriotis* case, supra, because there it was held that the administrative practice, which was found to exist, was consistent with the proper

construction and application of the relevant legislative provisions, whereas in the present instance there had existed only a concessionary policy and after it was discontinued the relevant legislation had to be applied on the basis of the particular facts of each individual case, such as the present one (see the *Panos Lanitis and Sons (Investment) Ltd.* case, supra, at p. 52).

Moreover, administrative practice cannot defeat a tax liability (see, inter alia, in this connection, Kyriakopoullos on Greek Administrative Law—Κυριακοπούλου "Διοικητικόν Δίκαιον" —4th ed., vol. A, p. 78).

It has, also, been argued by counsel for the applicants that the non-deduction from the taxable income of the applicants of the interest in question, while there continues to be deducted, by way of the existing concessionary practice, interest paid in respect of money borrowed for the purchase of shares in private companies, results in discriminatory and unequal treatment of the applicants, contrary to Article 28 of the Constitution.

In our view there do exist factors which, as a matter of taxation policy, appear to justify a differentiation as regards the treatment for purposes of deduction from taxable income of interest paid in respect of loans incurred for the purchase, on the one hand, of shares in public companies and for the purchase, on the other hand, of shares in private companies, in view of essential differences between public and private companies; and it must be borne in mind that both the legislative and the administrative authorities of a State are allowed considerable latitude in laying down policy in relation to fiscal and taxation matters (see, inter alia, in this respect, *Antoniades* v. *The Republic*, (1979) 3 C.L.R. 641 and *Apostolou and Others* v. *The Republic*, to be reported in the (1984) 3 C.L.R.)*.

In any event, once it has been found by us that in the present instance the sub judice decision of the respondent Commissioner not to deduct from the taxable income of the applicants the interest paid on money borrowed by them for the purpose of purchasing shares in a public company was reasonably open to him, both in fact and in law, the applicants cannot complain of being treated in a discriminatory manner because the res-

* Now reported in (1984) 3 C.L.R. 509.

pondent Commissioner continues to treat more leniently, by way of concession, interest paid in relation to money borrowed for the purchase of shares in private companies.

For all the foregoing reasons this recourse fails and has to be dismissed; but in all the circumstances of this case we will not make any order as to its costs.

Recourse dismissed. No order as to costs.