1985 May 3

[L. LOIZOU, J.]

IN THE MATTER OF ARTICLE 146
OF THE CONSTITUTION

COSTAS CHR. SIDERIS AND SONS LTD.,

Applicants,

v.

THE COMMISSIONER OF INCOME TAX,

Respondent.

(Case No. 44/73).

Income tax—Deductible expenses—Private company—Gratuity to Managing Director upon his retirement, as a result of age and ill-health—No obligation under any contract to employ him as a Manager—And not entitled as a Director to receive any gratuity—Said gratuity paid to him ex-gratia, a voluntary grant paid on personal considerations and not a necessary expense in the production of the income of the company— Not deductible under sections 11(1) and 13(e) of the Income Tax Laws, 1961 to 1969— And cannot be considered as a payment by way of Compensation for loss of office.

The applicant company, a private company with limited liability, was incorporated on the 25th January, 1964 for the purpose of taking over the business of Mr. Costas Chr. Sideris, who became a life Director of the Company. Although Mr. Costas Sideris was never formally appointed as Managing Director, he exercised for many years the powers and duties of Managing Director and in that respect he was receiving a remuneration of £1,800.- yearly from the company. Share-holders and Directors of the Company were, also, his wife and his two sons. As, due to age and ill-health, Mr. Costas Sideris resigned from the company on the 1st March, 1971, the Directors of applicant company recommended to the members the

payment to him of a gratuity and the annual general meeting of the 5th June, 1972, voted a gratuity of £8,000.- out of the profits of 1971.

On the 5th June, 1972, the applicants submitted audited accounts for the year 1971 showing for tax purposes a loss of £2,419.- after charging against profits the above sum of £8,000.-. The Commissioner of Income Tax decided that the aforesaid sum of £8,000.- could not be considered as an expense wholly and exclusively incurred in the production of the company's income; and could not qualify as a deductible expense for income tax purposes.

Upon a recourse by the applicant company:

Held, 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; that since there was no obligation under any contract to employ Mr. Costas Sideris as a Managing Director; and that since he was not entitled as a Director to receive any gratuity and that such gratuity was paid to him as an ex-gratia payment upon his retirement as a result of age and ill-health such payment was a voluntary grant paid on personal considerations and not as a necessary expense in the production of the income of the company; that such amount could not be treated as "outgoings and expenses wholly and exclusively incurred in the production of the income" of the company nor as "money wholly and exclusively laid out or expended for the purpose of acquiring the income" and, therefore, it is not deductible under the relevant provisions of the Income Tax Laws for income tax purposes (see section 11(1) and 13(e) of the Income Tax Laws, 1961 to 1969).

Held, that the payment in question was not by way of compensation for loss of office because it is clear from the material before this Court that Mr. Costas Sideris had retired not only due to ill-health but, also, due to age and it can hardly be said that in such a case even a Manag-

ing Director might be entitled upon his retirement to payment of compensation for loss of office.

Application dismissed.

Cases referred to:

Strong and Company of Romsey Ltd. v. *Woodifield,* 5 T. C. 215 at p. 219;

J. W. Smith (Surveyor of Taxes) v. *The Incorporated Council of Law Reporting of England and Wales,* 6 T. C. 477;

Mitchell (H. M. Inspector of Taxes) v. *B. W. Noble Ltd.* 11 T. C. 372;

Commissioner of Inland Revenew v. *Thompson Ltd. (in liquidation) and Others,* 37 T.C. 145;

Chibbett (H. M. Inspector of Taxes) v. *Joseph Robinson and Sons,* 9 T. C. 48;

Henry (H. M. Inspector of Taxes) v. *Foster and Hunter, Dewhurst,* 16 T. C. 605;

Manufacturers Life Insurance Co. v. *Republic* (1967) 3 C.L.R. 460.

Recourse.

Recourse against the decision of the respondent to add back to the chargeable income of the applicants for the year 1972(71) the amount of £8,000.- paid in 1971 to Mr. Costas Sideris, Director of the applicants, as a retirement gratuity.

V. Sarris, for the applicants.

E. Evangelou, Senior Counsel of the Republic, for the respondent.

Cur. adv. vult.

L. Loizou J. read the following judgment. By the present recourse the applicants pray for a declaration that the decision of the respondent Commissioner of Income Tax to add back to the chargeable income of the appli-

cants for the year 1972 (71) the amount of £8,000.- paid in 1971 to Mr. Costas Sideris, Director of the applicants, as a retirement gratuity, is null and void and of no effect whatsoever and that the said retirement gratuity is a proper deduction from applicants' chargeable income.

Costas Chr. Sideris and Sons Ltd., is a private company with limited liability which was incorporated on the 25th January, 1964 for the purpose of taking over the business of Mr. Costas Chr. Sideris, who became a life Director of the Company.

As stated by the applicants although Mr. Costas Sideris was never formally appointed as Managing Director, he exercised for many years the powers and duties of Managing Director and in that respect he was receiving a renumeration of £1,800.- yearly from the company. Shareholders and Directors of the Company were, also, his wife and his two sons.

As, due to age and ill-health, Mr. Costas Sideris resigned from the company on the 1st March, 1971, the applicants' Directors recommended to the members the payment to him of a gratuity and the annual general meeting of the 5th June, 1972, voted a gratuity of £8,000.- out of the profits of 1971.

On the 5th June, 1972, the applicants submitted audited accounts for the year 1971 showing for tax purposes a loss of £2,419.- after charging against profits the above sum of £8,000.-,

By his letter dated 14th August, 1972 (exhibit 1) the respondent requested applicants' auditors to explain why the gratuity was paid and the latter, by their reply dated 21st October, 1972 (exhibit 2) explained that Mr. Sideris was 67 years old and that he was the founder both of the applicant Company for which he worked since its foundation and of the business they took over, and that due to age he withdrew from active service in 1971.

The Commissioner of Income Tax decided that the aforesaid sum of £8,000.- could not be considered as an expense wholly and exclusively incurred in the production of the Company's income and communicated his decision

to the auditors of the Company on the 6th November, 1972 (exhibit 4).

Accordingly an assessment was raised on the sum of £5,632.- the balance remaining after deducting applicants' loss of £2,368.- for the year 1971, against which the applicants objected on the 17th November, 1972 (exhibit 5) but the respondent determined the objection on the 4th December, 1972, (exhibit 7) and issued a notice of tax payable by maintaining the original assessment.

Against the said assessment the applicants filed the present recourse, which is based on the following grounds of law:

1. Respondent's decision to disallow the payment of the retirement gratuity in question as a proper deduction from profits is erroneous as such gratuities are in Law allowable deductions.

2. The payment of a retirement gratuity to an officer or employee of a company is an expense "wholly and exclusively incurred for the purposes of the company's trade" and therefore a proper deduction from its profits.

3. In view of the fact that the expression "wholly and exclusively incurred for the purposes of the company's trade" means "wholly and exclusively incurred for the purpose of earning the company's income" the payment in question satisfies the requirements of subsection (1) of section 11 of the Income Tax Laws, 1961-1969.

4. The aforesaid expression means expenses incurred for the purpose of enabling one to carry on and earn profits in the trade, i.e. for the purpose of earning the profits.

5. Retirement gratuities are allowable deductions from profits as expenditures incurred for the purposes of the trade and because they are expenditures incidental to the trade itself.

6. Compensation payable for loss of office is an allowable deduction from profits.

7. Pensions, retirement gratuities and commutations of

pensions for a lump sum payment are allowed as proper deductions from profits.

8. Payments similar to the above are allowed as deductions in computing the profits of the payer company.

Counsel for the respondents opposed the application on the grounds that:

1. The recourse is out of time.

2. The assessment under recourse was properly and lawfully raised under Section 5(1) and 6 of the Income Tax Laws 1961 to 1969 and Sections 13(2)(b) of the Taxes (Quantifying and Recovery) Law No. 53 of 1963 as amended by Law No. 61 of 1969, after all relevant facts and circumstances were taken into consideration.

3. The objection to the above assessment was determined under Section 20(5) of the Taxes (Quantifying and Recovery) Law No. 53 of 1963 as amended by Law No. 61 of 1969.

4. The Respondent's decision not to allow as a deductible expense from the Applicant Company's income for the year 1971 a sum of £8,000.- styled in the Profit and Loss Account as "Retiring gratuity" and credited to Mr. Costas Chr. Sideris personal account with the Company, was properly and lawfully taken under Sections 11(1) and 13(e) of the Income Tax Laws 1961 to 1969.

At the commencement of the hearing the first ground of Law upon which the Opposition was based i.e. the time limit issue was abandoned.

It was argued by learned counsel for the applicants that the retirement gratuity is an allowable deduction in Law and that the payment of such gratuity is, in essence, compensation paid to Costas Sideris for loss of office after he gave up his appointment as Manager or Executive Director of the company.

Learned counsel for the respondent, on the other hand, argued that the gratuity concerned is not an allowable deduction under the provisions of section 11(1) and 13(e) of the Income Tax Laws 1961 to 1969 and that the decision

not to treat it as such was properly and lawfully taken.

The relevant parts of s.11 and 13 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;"

In the course of the hearing learned counsel for the applicants cited several cases in support of his case to which I propose to refer briefly:

In *Strong and Company of Romsey, Limited* v. *Woodifield*, 5 T. C. 215, it was held that the damages and costs incurred by a brewing company, which also owned houses and carried on the business of innkeepers, on account of injuries caused to a guest staying at one of their houses by the falling of a chimney upon him were not deductible for income tax purposes as they were unconnected with the trade.

The Lord Chancellor in delivering his opinion said (at p. 219):

"In my opinion however, it does not follow that if a loss is in any sense connected with the trade, it must always be allowed as a deduction; for it may be only remotely connected with the trade or it may be connected with something else quite as much as or even more than with the trade. I think only such losses can be deducted as are connected with it in the sense that they are really incidental to the trade itself. They cannot be deducted if they are mainly incidental to some other vocation, or fall on the trader in some character other than that of trade. The nature of the trade is to be considered."

Lord Davey stated the following in his opinion (at p. 220):

> "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 and 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."

The next case is that of *J. W. Smith (Surveyor of Taxes)* v. *The Incorporated Council of Law Reporting for England and Wales*, 6 T. C. 477, where it was held by Scrutton, J., that the finding of the District Commissioners of Taxes that the gratuity paid to one of the reporters of the Council on his retirement was allowable as a business expense in calculating the profits of the Council for income tax purposes could not be impugned as there was evidence justifying the Commissioners in arriving at such conclusion. The ground for the decision was that although the respondents 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, 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; and the employees expected to receive a gratuity on retirement, and, therefore, were likely to serve for somewhat smaller salaries than would otherwise be payable.

In the case of *Mitchell (H. M. Inspector of Taxes)* v. *B. W. Noble Ltd.*, 11 T. C., 372, it was held by the Court of Appeal that a lump sum of £19,200.- which had been paid to a Director by instalments 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 in the allegation of his colleagues he had been guilty of misconduct which might, possibly, entitle the company to dismiss him forthwith; 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 the Director and ultimately terms were agreed upon including the payment to him of the sum of £19,200.-

The decision of the Court was based on the ground that the payment was made in the course of business, not in order to secure an actual asset to the company, but in order to avoid publicity injurious to the company's reputation which might have caused difficulty in its business.

In *Commissioners of Inland Revenue* v. *Thomson Ltd. (in liquidation) and Others*, 37 T. C. 145, both the facts and the ground for the decision sufficiently appear from the headnote which reads as follows:

"The Respondent Companies were subsidiaries of S.D.C. Ltd. control of which was acquired by H. of F. Ltd. Changes of organisation which were made in accordance with the policy of the latter company involved the termination of the contracts of service of the managing directors of the Respondent Companies and also the eventual liquidation of those companies. Certain sums were paid by the Companies to the managing directors in connection with the cancellation of their contracts, the payments being expressed in the first two cases to be in satisfaction of rights to future remunaration, and in the third to be in lieu of notice.

On appeal to the Special Commissioners against assessments to Income Tax under Schedule D in respect of their profits the Companies contended that the payments were made to relieve them from onerous contracts and were allowable deductions. The Crown contended that the payments were not expenses of the Companies' businesses but were incidental to the schemes by which those businesses were acquired by H. of F. Ltd. and were made primarily for the latter Company's benefit. The Commissioners decided that the deductions claimed were allowable.

Held, that the decisions of the Special Commissioners were correct."

Reference has, also, been made to the cases of *Chibbett (H. M. Inspector of Taxes)* v. *Joseph Robinson and Sons*, 9 T. C. 48, and *Henry (H. M. Inspector of Taxes)* v. *Foster and Hunter, Dewhurst*, 16 T. C. 605. but I do not propose to deal with them specifically as the question in issue in these cases was whether the profits payable were assessable to tax in the hands of the recipient and not whether the outgoings were deductible expenses on the part of the payer.

Learned counsel for the respondents, on the other hand, cited the case of *The Manufacturers Life Insurance Co.* v. *The Republic* (1967) 3 C.L.R. 460, and relevant case-law referred to therein. In that case it was held by the Court that ex-gratia payments made by the applicant Insurance Company to its agents upon the termination of their contracts of employment as a result of its decision to discontinue new insurance business in Cyprus did not qualify as allowable deductions for income tax purposes 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.

It clearly emerges from the authorities 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 taxpayer the better to carry on his trade or business for the purpose of earning the income, whether by getting rid of onerous service agreements of for the purpose of maintaining a high standard of business.

In reaching a decision on the issues raised in the present case I have taken into consideration the approach adopted in the above referred cases bearing always in mind that each case has to be decided on its own particular facts and circumstances.

In so far as the case in hand is concerned there is no dispute that Mr. Costas Sideris was a Director of the Company, that there was no obligation under any contract to

employ him as a Managing Director, that he was not entitled as a Director to receive any gratuity and that such gratuity was paid to him as an ex-gratia payment upon his retirement as a result of age and ill-health. On the facts of the case such payment was, in my view, a voluntary grant paid on personal considerations and not as a necessary expense in the production of the income of the company. Such amount could not be treated as "outgoings and expenses wholly and exclusively incurred in the production of the income" of the company nor as "money wholly and exclusively laid out or expended for the purpose of acquiring the income" and, therefore, it is not deductible under the relevant provisions of the Income Tax Laws for income tax purposes.

Nor do I accept as correct the submission of counsel for the applicants that such payment was by way of compensation for loss of office because it is clear from the material before me that Mr. Costas Sideris had retired not only due to ill-health but, also, due to age and it can hardly be said that in such a case even a Managing Director might be entitled upon his retirement to payment of compensation for loss of office.

In the light of all the circumstances of this case it was, in my view, reasonably open to the Commissioner to come to the conclusion that the payment in question was not an allowable deduction for income tax purposes and, therefore, I cannot interefere with such decision.

In the result this recourse fails and it is hereby dismissed.

There will be no order as to costs.

Recourse dismissed.
No order as to costs.