1988 August 29

[SAVVIDES, J.]

IN THE MATTER OF ARTICLE 146 OF THE CONSTITUTION

ETERIA METAPHORON AYIA NAPA (EMAN) LTD.,

Applicant,

v.

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

Respondents.
(Case No. 268/86).

Taxation—Income Tax—Deductible expenses—The Income Tax Laws, 1961-1981, sections 11(1), 13(e) and (f)—Damages paid to third parties for damages to the latters' vehicles caused by the applicants' vehicles—Applicants engaged in the transport business—Whether the said expenses incurred wholly and exclusively in the production of income—Question determined in the negative—Therefore, they were not deductible.

Taxation—Income Tax—Deductible expenses—The Income Tax Laws, 1961-1981, sections 11(1) and 13(e) and (f)—Payment by applicants, who were engaged in public transport, for acquiring a "T" licence—Not an expense wholly and exclusively incurred in the production of income—Therefore, not deductible.

Taxation—Income Tax—Deductible expenses—The Income Tax Laws 1961-1981, sections 11(1) and 13(e) and (f)—Expenses wholly and exclusively incurred in the production of income—Review of authorities.

The facts of this case, as well as the principles evolved therefrom, are sufficiently indicated by the hereinabove headnotes.

Recourse dismissed with £100.- costs in favour of respondents.

Cases referred to:

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

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

Recourse.

Recourse against the income tax assessments for the years of assessment 1981 and 1982 and against the special contribution assessments for the quarters 1.1.81 - 31.12.82 raised on applicants.

A. Panayiotou, for the applicants.

Y. Lazarou, for the respondents.

Cur. adv. vult.

SAVVIDES J. read the following judgment. The present recourse is directed against applicant's income tax assessments for the year of assessment 1981 and 1982 and also against the special contribution assessments for the quarters 1/81 to 4/82 which were raised and determined as shown in Appendixes "A" and "B" attached to the Opposition

The applicant is a private limited company engaged in transport and its income at all material times to the present recourse was derived from the transport of passengers and goods. The applicant company submitted audited accounts for the year ended 31.1.82 on 6.11.82 through Mr. T. Christofides, Certified Accountant, and for the year ended 31.1.83 on 30.5.84 through Mr. E. Kallenos, Chartered Accountant.

The accounts of the company for the year ended 31.1.80 to 31.12.83 were examined and the company's auditor was requested by the respondent Commissioner of Income Tax by letter dated

2nd February, 1985 to produce certain additional information. This information was supplied on the 29th April, 1985. On the basis of the examination of the company's accounts and the additional information received for the years of assessment 1979 to 1983, assessments were raised and sent to the applicant company on the 3rd October, 1985.

The company's auditor by letter dated 21st October, 1985 accepted the income tax and special contribution computations as adjusted by the respondent subject to the following two matters stated therein:

(i) Year of assessment 1981 (Year ended 31.1.82)

An objection was raised in this respect against an amount of £2,145.- claimed as "compensation paid to various car owners re accidents caused by the company's vehicles which were not covered by insurance", which was rejected by the Commissioner of Income Tax.

(ii) Year of assessment 1982 (Year ended 31.1.83)

An objection was raised against the deduction from the income of an amount of £9,000.- being the alleged cost of purchase of "T" licences, which was also rejected by the respondent.

The objection contained in the above letter of the applicant was rejected by the respondent who by letter dated 18th November, 1985, informed the applicant that the two aforementioned items could not be allowed for income tax purposes for the reason that (a) compensation paid to third persons for damage caused are not expenses wholly and exclusively incurred for the acquisition of income and, as such, they were not deductible; (b) any amount paid for the purchase of "T" licences is not allowed by law and that in any event such expenditure could not be considered as an expenditure for the acquisition of income.

The applicant's auditor replied to the respondent by letter dated

5th December, 1985, expressing his disagreement to the disallowance of the second item mentioned in the letter of the respondent dated 18th November, 1985, that is, concerning the allowability of the expenditure incurred for purchasing "T" licences without mentioning anything concerning the first item contained in such letter, that is, the compensation payments to third parties.

The respondent Commissioner of Income Tax, having considered the objection filed on behalf of the applicant and bearing in mind all subsequent documents submitted by the applicant's auditors, maintained his original decision and determined the objection accordingly and informed the applicant of his decision by letter dated 22nd February, 1986. As a result, the applicant filed the present recourse challenging the sub judice decision.

The sole question which poses for consideration is whether the two items claimed by the applicant, in particular, the amount of £2,145.- paid as compensation to third parties for damage caused to their cars by the Company's vehicles which were not covered by insurance, and the amount of £9,000.- alleged to have been paid for the purchase of "T" licences are deductible expenses.

Counsel for the applicant submitted that the two aforesaid items are deductible as they are expenses incurred in the proper carrying out of the business of the company and that the respondent, in refusing to deduct them, acted arbitrarily and without any legal or reasonable justification.

Counsel for the respondents, on the other hand, submitted that such claim was not deductible under the provisions of sections 11 and 13 of the Income Tax Laws 1961-1981 in that, for it to be deductible (a) it must be revenue and not capital expenditure; (b) the expenditure was not incurred wholly and exclusively for the purpose of acquiring the income.

The legal provisions relevant to the issues under consideration are contained in sections 11 and 13 of the Income Tax Laws 1961-1981. Section 11(1) deals with allowable deductions and

provides, inter alia, that in ascertaining the chargeable income of any person there shall be deducted all outgoings and expenses wholly and exclusively incurred in the production of the income. This section, however, should be read in conjunction with s.13 which expressly prohibits certain deductions. In particular, paragraph (e) to this section provides that to be deductible, the expenditure must be money wholly and exclusively set out or expended for the purposes of acquiring the income and paragraph (f) provides that no deduction shall be made on any capital withdrawn or any sum employed or intended to the employed as capital.

The expression "for the purposes of acquiring the income" has been considered in the case of *The Manufacturers Life Insurance Co. v. The Republic* (1967) 3 C.L.R. 460, in which Loizou, J., after making reference to the case of *Strong and Company of Romsey Ltd. v. Woodifield,* 5 Tax Cases 215, said the following at p. 471:

> "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."

and concluded by treating payments effected by the applicant company in that case to agents for the purpose of carrying on and acquiring income in its business as payments which had not been made wholly and exclusively for the purpose of enabling the company to carry on its business and earn income.

In *Strong and Company of Romesy Ltd. v. Woodifield* (supra), to which reference was made in the above decision, it was held that 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 in of a chimney were not deductible

for income tax purposes as they were not expenses which were made for the purpose of earning the profits. Lord Davey, in delivering his judgment, said the following, at p. 220:

"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."

On the basis of the material before me and bearing in mind the above, I have come to the conclusion that these 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 acquire income.

In the circumstances, I think it was reasonably open to the respondent 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 £100.- costs in favour of the respondents.

Recourse dismissed with £ 100.- costs in favour of respondents.