1988 February 18

[LORIS, J.]

IN THE MATTER OF ARTICLE 146 OF THE CONSTITUTION

MIRATOR BEACH LTD AND ANOTHER,

Applicants,

v.

THE REPUBLIC OF CYPRUS, THROUGH
1. THE DIRECTOR OF INLAND REVENUE,
2. THE MINISTRY OF FINANCE,

Respondents.

(Cases No. 483/85 and 649/85).

Taxation—Income tax—Deductible expenses—Interest on loan by private company used to acquire land on which to construct a hotel—Decision to disallow its deduction on the ground that it referred to capital expenditure—The Income Tax Laws, sections 11(1) and 13(e) and (f)—Sub judice decision reasonably open to respondent.

Taxation—Income tax—Concessionary practice—Cannot defeat tax liability.

Taxation—Income tax—Deductions—Onus of proof—Judicial control—Principles applicable.

Taxation—Income tax—Acquisition of shares by a company in another company—Interest on loan used for such acquisition—Whether deductible—Circular 115 of 10.9.69—Change of policy—As a concessionary practice cannot defeat a tax liability and as, in any event, at the material time the policy had changed, the deduction was rightly disallowed.

The applicant company in recourse 483/85 was incorporated in 1977 for the purposes of acquiring land on which to erect a hotel complex. The purchase of the land was financed by a loan and share capital paid in by the shareholders; the actual construction of the hotel commenced in 1983.

The respondent decided that the interest on the loan used for the purchase of the land is not a deductible expense for income tax purposes for the years 1978-1982, whereas as from 1983, when the construction of the hotel complex began, it would be considered as deductible.

Recourse 483/85 is directed against the said decision. The payment, argued counsel were not made wholly and exclusively for the purposes of acquiring the income but the land, which constitutes the source of income and not the income itself.

Counsel argued that it is by way of concession that the interest payable after 1983 was decided to be deducted for purposes of income tax.

The applicants in recourse 649/85 are, also, a private company limited by shares. They sought to deduct interest paid for the acquisition of shares in the company which filed the first of the above recourses, i.e recourse 483/85.

The applicants in 649/85 relied on a circular, i.e. Circular 115 of 10 9.69 by the Commissioner for Income Tax, in accordance with which the interest is deductible irrespective of how the monies paid for the acquisition were used by the company, whose shares were purchased by the other company.

Counsel for the respondent stressed that the policy expressed by the circular changed as from 1969. The new conditions appear in respondent's Manual

Held, *dismissing both recourses* (A) (1) The onus is on the applicant to show that he is entitled to a deduction under the provisions of the Law; if the respondent's decision was one that was reasonably open to him, this Court does not interfere.

(2) In the light of the above and of the case law, land is an asset of capital nature not yielding income, and therefore, on the basis of the relevant legislative provisions, it was reasonably open to the respondent to arrive at the conclusions, he did, having considered the facts aforesaid.

(3) As administrative practice, in the form of a concession, cannot defeat tax liability, the allowances for the interest payable after 1983, when the construction of the hotel began, do not absolve the applicants from their tax liabilities for the previous years.

(4) It follows that recourse 483/85 has to be dismissed.

(B) The applicant in case No. 649/85 cannot rely on a concessionary policy of the respondent which was discontinued and was not in force at the material time for this case; furthermore an administrative practice in the form of a concession cannot defeat tax liability.

Recourses dismissed.
No order as to costs.

Cases referred to:

HadjiYiannis v. Republic (1966) 3 C.L.R. 338;

Panos Lanitis and Sons (Investments) Ltd. v. The Republic (1984) 3 C.L.R. 1598;

Kittides v. The Republic (1973) 3 C.L.R. 123;

Georghiades v. The Republic (1982) 3 C.L.R. 659;

Ceorghiades v. The Republic (1985) 3 C.L.R.1627;

River Estates Ltd. v. The Republic (1986) 3 C.L.R. 2575;

Atherton v. British Insulated and Helsby Cables Ltd., 10 T.C. 155;

Hellenic Bank Ltd. v. The Republic (1986) 3 C.L.R. 267; and on Appeal (1987) 3 C.L.R. 1619;

Panos Lanitis and Sons (Investments) Ltd. v. The Republic (1973) 3 C.L.R. 667.

Recourses.

Recourses against the refusal of the respondent to allow as deductible expense for income tax purposes interest paid by applicants in connection with loans used for the purchase of land and the acquisition of shares in a private company.

A. Skordis, for applicants.

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

Cur. adv. vult.

LORIS J. read the following judgment. The above intituled recourses were heard together on the application of both sides as they revolve on the same main legal issue, notably the distinction between capital and revenue expenditure.

By means of recourse No. 483/85 the applicant company challenges the refusal of the Commissioner of Income Tax to allow, as deductible expense for income tax purposes, interest paid by the applicants for the years 1978-1981 in connection with a loan used for the purchase of land, which was intended for development into a hotel complex.

The applicant company was incorporated in 1977 as a private limited company with an authorized share capital of £1,000,000. It was formed for the purposes of acquiring land on which to erect a hotel complex at an estimated cost of £1,000,000 and carry on the business of a hotelier. The said land was financed by a loan and share capital paid in by the shareholders; the actual construction of the hotel commenced in 1983.

On the basis of audited accounts and income tax computations for the years 1978 to 1981, income tax assessments were raised provisionally by the respondent on the income of the company for those years.

In 1983 on examination of the accounts of the company, a re-adjustment was made, by disallowing the interest debited in the accounts in respect of the loan used for the purchase of the land intended for the development into a hotel complex, and revised assessments were issued on 2 December 1983.

On receiving such assessments the applicant company's auditors objected, on 27 December 1983, on the ground that the

company did not have any chargeable income during the said years.

The respondent Commissioner having examined the objection decided to maintain the assessments and communicated his decision by means of a letter dated 13 February 1985, in which it is stated that the interest paid on loan used to acquire the land in 1978, is considered as an expense of a capital nature for the years 1978 to 1982, enhancing the value of the land, and, therefore, not allowable and, further, that such an expense should be a proper deduction as from the year 1983, when the construction of the hotel complex began.

It is against this decision that recourse No. 483/85 was filed.

From what had been stated in the written addresses of counsel for the applicants, it appears that the case rests on proper construction and application of the relevant legislative provisions to the particular facts of the present case, which are sections 11 and 13 of the Income Tax Laws.

Section 11(1) deals with the allowable deductions and provides 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. By means of paragraph (e) of section 13 it is provided that there will be no deduction for any expenditure unless such expenditure is money wholly and exclusively set out or expended for the purposes of acquiring the income and by means of paragraph (f) provision is made that there will be no deduction on any capital withdrawn or any sum employed or intended to be employed as capital.

It is the stand taken by counsel for the respondents, that the interest payable in this case is not in law qualified as a deductible expense, because the payments were not made wholly and exclusively for the purposes of acquiring the income but the land, which constitutes the source of income and not the income itself (see *HadjiYiannis* v. *The Republic* (1966) 3 C.L.R. 338, 352)

and that it was a capital expenditure, irrespective of whether the land was intended to be used for the erection of a hotel, and irrespective of whether the hotel might subsequently yield income. Counsel argued that it is by way of concession that the interest payable after 1983 was decided to be deducted for purposes of income tax.

He referred in this respect to the case of *Panos Lanitis and Sons (Investments) Limited v. The Republic* (1984) 3 C.L.R. 1588, where (at pp. 1592-1593), the following are stated:

"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, 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 other hand counsel for the applicant company maintained that under the circumstances of the case, the interest paid was not a capital expenditure but money used for the purposes of acquiring the income and that the distinction made by the respondents, between the time before and after the beginning of the construction of the hotel is unfounded.

In deciding a case of this nature it must be borne in mind, that the onus is on the applicant to show that he is entitled to a deduction under the provisions of the Law (vide *HadjiYiannis*, supra, 350, and *Kittides v. The Republic*, (1973) 3 C.L.R. 123, 133) and that if the respondent's decision was one that it was reasonably open to him, this Court does not interfere (vide *Georghiades v. The Republic*, (1982) 3 C.L.R. 659, 667, 669 *Panos Lanitis and Sons (Investments) Limited*, supra, 1593, *Georghiades v. The Republic*, (1985) 3 C.L.R. 1627, 1633 and *River Estates Ltd. v. The Republic* (1986) 3 C.L.R. 2575, 2585).

Having considered the aforesaid main issue in the light of *Atherton v. British Insulated and Helsby Cables Ltd., 10 T.C* 155 at p. 192, and bearing in mind, as well, the principles expounded in the *Lanitis* case, supra, agreeing at the same time with the view expressed by my brother Judge A. Loizou in *River Estates Ltd. case*, supra, (at p. 2585), I hold the view that interest paid on borrowed money for the purchase of land, is an asset of capital nature not yielding income, and therefore, on the basis of the relevant legislative provisions, it was reasonably open to the respondent Commissioner to arrive at the conclusions, he did, having considered the facts aforesaid.

As under the provisions of the Law, applicants are not entitled to the deductions claimed, and, as an administrative practice, in the form of a concession, cannot defeat tax liability, (see, inter alia, *Lanitis* case, supra, at p. 1594 - *Hellenic Bank Ltd. v. The Republic* (1986) 3 C.L.R. 267 at p. 276 and on appeal (1987) 3 C.L.R. 1619) the allowances made in their favour by the respondent Commissioner, for the interest payable after 1983,

when the construction of the hotel began, do not absolve them from their tax liabilities for the previous years.

For all the above reasons recourse under No. 483/85 is doomed to failure.

Applicant company in recourse No. 649/85 challenges the decision of the respondent Commissioner, not to allow as a deduction, interest paid for the years 1977 - 1981, in connection with a loan used by the applicant for the acquisition of shares in a private company namely Mirator Beach Ltd., i.e. the applicant in recourse No. 483/85.

The reasons for dismissing the claim of the applicants in case No. 649/85 as contained in a letter of the Respondent dated 20 February, 1985, is that the interest paid on the loan for the purchase of the shares were not expenses incurred for the purpose of acquiring the income, since Mirator Beach Ltd. used the funds accrued from the sale of the shares, in order to acquire land, the development of which started in 1983.

Apart from the common main issue arising in both aforesaid cases, which has already been determined above, this latter case presents another side issue notably the effect of Circular No. 115 addressed by the respondent Commissioner to All Assessing Staff on 10.9.69 (vide Appendix "A" attached to the written address of the applicant).

Learned counsel for the applicant relying on the aforesaid circular submitted that, interest in respect of money borrowed for the purchase of shares in a private company are allowable deductions for purposes of income tax, irrespective of the purpose for whch the applicant company in case No. 483/85 had used the money accrued from the sale of its shares.

Learned counsel for the respondent conceded that the respondent allowed interest for the purchase of shares in private companies but stressed (a) that this was done by way of

concession (b) that this policy has changed since 1969 and it is now granted subject to certain conditions which appear in Respondent's manual (Ex. 1) paragraph (b) of which reads as follows:

"INTEREST ON LOANS FOR NON-TRADING PURPOSES

The Concessional deduction in respect of payments of interest should be restricted to interest on money borrowed for any of the purposes mentioned below:-

(a) Residence .....

(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. In cases where a capital asset is acquired by a private company which is of such a nature that had it been acquired by an individual would not entitle him to claim interest on money borrowed for its acquisition, the purchase of shares in, or the lending of money to, such private company, in order to finance the purchase of such asset, would not entitle a person to claim interest on money borrowed for the purchase of shares in, or the lend of money to, such company.".

From the above conditions, learned counsel for the respondent maintained, it is clear that the concession is only available in cases where the asset acquired by the company is of such a nature that had it been acquired by an individual, would entitle him to claim interest on money borrowed for its acquisition; and counsel added "in the present case, Mirator Beach Hotel, the shares of which were acquired by Applicant, used the funds acquired to finance the purchase of land, an asset of capital nature not yielding income and which would not have been allowed in the case of an individual."

Having carefully considered this additional issue, I have come

to the conclusion that the applicant in case No. 649/85 cannot rely on a concessionary policy of the respondent which was discontinued and was not in force at the material time of this case; furthermore an administrative practice in the form of a concession cannot defeat tax liability (vide *Lanitis* case, supra, at p. 143).

Since a concessionary policy could freely be revoked by the administration (vide *Stassinopoulos on the Law of Administrative Acts*, 1951, p. 409 and *Panos Lanitis & Sons (Investments) Ltd. v. The Republic* (1973) 3 C.L.R. 667, 685, 686), more so, in the exercise of their discretionary powers, they could freely impose conditions in granting allowances, to which the tax-payers are not otherwise entitled under the relevant legislative provisions.

In the result both recourses fail, for the reasons I have endeavoured to explain above; and they are accordingly dismissed. Let there be no order as to costs.

Recourses dismissed.
No order as to costs.