1988, May 10

[A. LOIZOU, P.]

IN THE MATTER OF ARTICLE 146 OF THE CONSTITUTION

GEORGHIOS KONARIS AND ANOTHER,

Applicants,

v.

THE REPUBLIC OF CYPRUS, THROUGH
1. THE COMMISSIONER OF INCOME TAX,
2. THE DIRECTOR OF INLAND REVENUE,

Respondents.

(Case No. 378/85, 379/85).

Taxation—Income Tax—The Income Tax Laws 1961 - 1983, section 12(2)(a)—Deduction for wear and tear of property—The property should be owned by the person claiming the deduction and should be used in his trade during the relevant year of assessment.

Taxation—Income Tax—The Income Tax Laws 1961 - 1983, sections 11(1) and 13—Deduction of interest—The loan in question should have been applied to the production of applicant's income.

Taxation—Income Tax Laws 1961 - 1983, sections 11(1) and 13—Deduction of interest—Obligation to pay interest extinguished by Law—No question of deduction arises.*

Taxation—Income Tax—Sale of Land—Profit therefrom—When liable to income tax—Principles applicable.

The sub judice income tax assessments are challenged on the following grounds, namely:

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* *Section 4(1) of the Stricken Debtors' (Temporary Provisions) Laws 1979 - 1985.*

a) The respondent wrongly failed to allow wear and tear in respect of a building of the wives of the two applicants situated in Kyrenia. The building had been financed by a loan obtained by the two applicants from a Bank.

b) The respondent failed to deduct the amount of the interest charged on the said loan.

In addition, applicant Lartides complains that the respondent wrongly considered as taxable the profit, which the applicant had realized by the sale of a piece of land, because, as the applicant alleged, the land had been acquired for investment.

Held, *dismissing the recourse.*

(1) The matter of wear and tear is governed by section 12(2)(a) of the Income Tax Laws 1961 - 1983. The word "property" is defined in section 12(1).

Wear and tear allowance is allowed in respect of property which in the first place is owned by the person claiming such a deduction and secondly which is used and employed in his trade, during the year of assessment in question.

In this instance the property in question is owned by the wives of the applicants. The fact that such property may have been financed by money obtained by the applicants, as alleged, does not alter the fact that such property is not owned by them.

2) The deduction of interest is governed by sections 11(1) and 13(e) of the said laws. The sub judice decision is correct, because the loan in question was not employed in the production of the taxpayers' - applicant's income and, also, because the applicants were stricken debtors and, consequently their obligation to pay interest for the period as from 14.8.74 was extinguished.*

3) The taxability of profits from the sale of land must be decided in the light of the particular circumstances of each case. If a transaction is found to be "an adventure in the nature of trade" such profits are taxable. Isolated transactions though often may lack the features of trade do not preclude the possibility that such transaction may be in the nature of trade.

* *The Debtors' Relief (Temporary Provisions) Law 1979 - 1985, section 4(1).*

The applicant failed to establish that his version of the facts is the correct one.

Recourse dismissed
No order as to costs.

Cases referred to:

Union Cold Storage Co. Ltd. v. Jones (Inspector of Taxes), 8 Tax Cases, 725;

Corporation of Birmingham v. Barnes (H.M. Inspector of Taxes), 19 Tax Cases 214;

Triantafyllides v. National Bank of Greece (1983) 1 C.L.R. 469;

Cyprus Hotels Ltd. v. The Republic (1985) 3 C.L.R. 2772;

Agrotis v. Commissioner of Income Tax, 22 C.L.R. 27;

HjiEraclis v. Commissiner of Income Tax (1984) 3 C.L.R. 604;

Varnavides v. The Republic (1986) 3 C.L.R. 1385.

Recourses.

Recourses against the income tax assessments raised on applicants for the years of assessment 1975 - 1983.

C. Melas with Chr. Demetriou, for the applicants.

Y. Lazarou, for the respondents.

Cur. adv. vult.

A. LOIZOU P. read the following judgment. By the present recourses which were heard together as they present common question of law and fact, the applicants claim a declaration of the Court that the income tax assessments raised by the respondent

Commissioner against the applicants are null and void and of no legal effect whatsoever.

Applicant Georghios Konaris who derived his income, during the material times, from share of profit from the partnership "Larticon Synthetic Detergents Company", rents and as from the year 1980 Social Insurance pension, filed recourse No. 378/85 as against the income tax assessment for the years of assessment 1975 to 1983.

Applicant Socratis Lartides who also derived his income, during the material times, from the profits as a partner of the firm "Lartico Synthetic Detergents Company" and as from 1981 Social Insurance pension, filed recourse No. 379/85 as against the income tax assessments for the years of assessment 1975 to 1981 and 1983.

The respondent Commissioner did not accept the returns and accounts submitted by the applicants in respect of the years in question and raised assessments according to his judgment as is provided by section 13(2)(b) of the Assessment and Collection of Taxes Law, 1978 (Law No. 4 or 1978). Against such assessment the applicants filed objections as they found that they were excessive and not in accordance with the chargeable income declared in their returns of income.

The respondent Commissioner examined the matter and proceeded with the determination of the assessments, as against which the applicants filed these recourses.

It was contended that the respondent wrongly decided to disallow (a) wear and tear allowance in respect of a building in Kyrenia owned by the wives of the applicants and (b) interest charged on loans contracted prior to the 14th August 1974 by the applicants and their wives for the purpose of financing the construction of the latter's building.

The said building, a complex of tourist appartments was built

between 1973 and 1974 in Kyrenia on a plot owned by 1/2 share each by the wives of the applicants. As it is claimed, 1/2 of the cost of such building was financed by means of a loan obtained from Grindlays Bank by the applicants to the extent of 1/2 share each. It was contended therefore that since the said buildings were in effect financed and paid for by the applicants that the respondent Commissioner wrongly disallowed wear and tear allowance in respect of such buildings, and secondly for the same reason, that he wrongly disallowed a deduction of the interest charged on the aforesaid loan.

The matter is governed by section 12(2)(a) of the Income Tax Laws 1961 - 1983 which provides as follows:

"(2) In ascertaining the chargeable income of any person engaged in a trade, business, profession, vocation or employment, there shall be allowed -

(a) subject to the provisions of this section, a deduction of a reasonable amount for the exhaustion and wear and tear of property arising out of the use and employment of such property in the trade, business, profession, vocation or employment during the year of assessment:"

and "property" is defined by section 12(1) thereof as "plant, machinery or buildings ..... owned by a person engaged in a trade .... and used and employed by such person in such trade ...".

As correctly argued on behalf of the respondents wear and tear allowance is allowed in respect of property which in the first place is owned by the person claiming such a deduction and secondly which is used and employed in his trade, during the year of assessment in question. Support for this view may also be found in the English case of *Union Cold Storage Co. Ltd. v. Jones (Inspector of Taxes)*, 8 Tax Cases p. 725 at 736.

"It has to be wear and tear of machinery and plant used for the purpose of the trade and belonging to the person by whom it is carried on: it must be used for the purpose of the trade of the Appellant Company. All I can say is, the machinery and plant is not. I think 'used for the purpose of the trade of the Appellant Company' means that the Appellant Company are making profits by using and causing the wear and tear of the machinery. That is what I think the scope of this is. This is used in the trade of the other company and of course prima facie the depreciation of the plant and machinery cannot be allowed as a deduction: it has got to be brought within these words which create the allowance, and, if it is not within the words, it is not within the words. It cannot be allowed on general principle: the words 'used for the purpose of trade' must be satisfied, and all I can say is I do not think they are."

This decision was upheld by the Court of Appeal where it was held at p. 738 (supra) as follows:

"Deductions may be allowed in respect of money wholly and exclusively laid out or expended for the purposes of the trade, manufacture or concern of the subject making the return for Income Tax purposes. It is plainly seen by reading those words that it is not all money that is laid out by the subject but only money which is laid out, first of all, for the purposes of the trade, and, secondly, laid out wholly and exclusively for the purposes of the trade, and unless the expense incurred can be brought within these words which are narrow words the deductions cannot be allowed. It is quite plain the intention of the Legislature was not to make a broad general rule that whatever a subject likes to expend in his business could be deducted but only such sums were to be allowed to which the character could be assigned that they had been wholly and exclusively laid out for the purposes of the subject's business."

In this instance the property in question is owned by the wives of the applicants. The fact that such property may have been fi-

nanced by money obtained by the applicants, as alleged, does not alter the fact that such property is not owned by them and therefore, in the circumstances I find that it was correct in law the respondent Commissioner to decide, as he did.

Before concluding I wish to refer to the following passage from the case of *Corporation of Birmingham v. Barnes (H.M. Inspector of Taxes)*, 19 Tax Cases 214 at 217:

"What a man pays for construction or for the purchase of a work seems to me to be the cost to him; and that whether someone has given him the money to construct or purchase for himself, or before the event has promised to give him the money after he has paid for the work, or after the event has promised or given the money which recoups him what he has spent."

As far as the question of interest charged on the loan by the applicants for the purpose of financing the construction of their wives' property is concerned, I consider that the respondent Commissioner correctly decided that such is not deductible. The matter is governed by sections 11(1) and 13(e) of the Income Tax Laws 1961-1983 which provide 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,"

and,

"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 acquir-

ing the income;"

The provisions of the law are clear and since in this instance the loan in question was not employed in the production of the taxpayers' - applicants' income, equally any interest payable on such loan cannot be considered as deductible.

Secondly, according to the applicants' auditor, no interest was in fact paid in respect of the loan in question since 1975 on the ground that both the applicants and their wives are stricken debtors. This allegation was neither disputed by the applicants nor denied, so it must be taken as correct.

In accordance with the provisions of section 4(1) of the Debtor's Relief (Temporary Provisions) Laws 1979 - 1985 a debtor's obligation to pay interest is completely abolished after 1974 and as long as the abnormal situation continues, See: *Triantafyllides v. National Bank of Greece* (1983) 1 C.L.R. 469 at 476; *Cyprus Hotels Ltd. v. Republic* (1985) 3 C.L.R. 2772, where it was held at p. 2778:

"Consequently, since the liability of the applicant company to pay interest is completely extinguished, the amount of such interest cannot be allowed as a deductible expense, as it no longer constitutes an amount due and is, therefore, taxable."

In the result recourse No. 378/85 fails and is hereby dismissed.

As far as recourse No. 379/85 is concerned there remains one further point to be considered.

Applicant Lartides also further contended that an amount of £3,000.- of profit realised by him from the sale of land at Latsia was not taxable as the amount was capital profit and not profit arising from an adventure in the nature of trade. He claimed that the said land was bought for the purpose of setting up therein a chocolate factory but as he was unable to obtain a loan from the

Bank to finance the project, he was obliged to sell the land.

According to the contract of sale the said land was purchased on the 13th June 1976 by a certain Georghios Georgakakis for the total amount of £10,500.-. At some subsequent date - which was considered by the respondent Commissioner as the 4.11.76, the date of the transfer of the land - the applicant became a co-owner by 1/2 share in the land.It is further alleged by the respondents that the application for the financing of the project was made on the 3.7.76 by the said Georgakakis alone and such was turned down by the Bank on the 11.9.76 long before the applicant bought his 1/2 share in the land. This does not appear to have been denied by the applicant.

The general principle is that the taxability of profits from the sale of land must be decided in the light of the particular circumstances of each case. (See: *Agrotis v. Commissioner of Income Tax*, 22 C.L.R. 27.) And if a transaction is found to be "an adventure in the nature of trade" such profits are taxable. Isolated transactions though often may lack the features of trade do not preclude the possibility that such transaction may be in the nature of trade.

The general principles concerning this matter appear extensively in the case of *HjiEraclis v. Commisioner of Income Tax* (1984) 3 C.L.R. 604 at 612-615, *Varnavides v. Republic* (1986) 3 C.L.R. 1385. I need therefore not repeat them. So far as they apply to the facts of the present case, I consider that the applicant has failed to establish that his version of the facts is the correct one and I find therefore that in the circumstances this was an adventure in the nature of trade and the profits arising therefrom were correctly considered as taxable.

Even if I were to accept the applicants' version that he bought the land for the sole purpose of building therein a chocolate factory, and since as he alleges the only reason for disposing the land was the fact that the project fell through, I consider it unlikely that the applicant who appears to be a versatile businessman involved

either directly or indirectly in more than one type of business, could not have foreseen the probability of the Bank turning down his application for a loan. This leads me to the only obvious conclusion that the land was not acquired as an investment.

In any case having considered the position as put before me, I find that the applicant has failed to convince me that the sub judice decision must be disturbed as on the facts I find that it was reasonably open to the respondent Commissioner to reach the conclusion that the transaction was in the nature of trading in land. The circumstances he acquired the land and the relevantly short time he held on it is not characteristic of a man, a landowner who having found his property appreciating in value sells part of it and utilises the profits in order to further develop the remainder.

For the reasons stated above both these recourses fail and are hereby dismissed, but in the circumstances there will be no order as to costs.

Recourses dismissed.
No order as to costs.