The Imposition of Income Tax in Cyprus in 1941: A Historical Note

Peter Clarke

Abstract

This paper outlines the context of the introduction of income tax to the Colony of Cyprus in 1941, just after the commencement of World War II, and it reviews some of the technical provisions contained in the income tax legislation. In addition, this paper argues that the 1941 legislation had a number of important political, social and economic consequences which, until now, have been largely unresearched. However, additional investigation needs to be undertaken in this area before a comprehensive narrative can be finalised.

Keywords: Cyprus, income tax history, accountancy profession

Introduction

> *Cyprus, Syria and Palestine have made such a conspicuous figure in the page of history, that an account of them must prove highly interesting to those who are fond of researches into the situation of remote nations.* (Mariti, 1791, p. v)

This paper originated from casual conversations between the author and some professional tax practitioners in Cyprus. The author noted that none of these tax professionals were aware of the background associated with the imposition of income tax in Cyprus in the early years of World War II. This paper attempts to make a contribution to our knowledge of the economic history of Cyprus. Specifically, it focuses on the imposition of income tax in Cyprus from 1 January 1941. It presents the technical aspects of this income tax legislation and outlines some of the (unintended) consequences resulting from the introduction of this new legislation.

In contrast with the above quotation by Mariti (1791) over 200 years ago, it is fair to suggest that very little has been published in the area of the taxation history of Cyprus. Indeed, Thacker's (1954) *Memorandum* on income tax in Cyprus is the only specific publication identified as directly relevant to this paper. The *Memorandum*

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was prepared on behalf of the Cyprus Federation of Trade and Industry and critically compared aspects of the income tax system in Cyprus during the early 1950s with the United Kingdom and other colonies. One should note the well-known and important publications that relate to aspects of the business history of Cyprus. These include, for example, Jenness' (1962) study of the economics of Cyprus to 1914, *The Story of Cyprus Mines Corporation* (Lavender, 1962), *Banking in a British Colony: Cyprus 1878 – 1959* (Phylaktis, 1988) and Meyer's (1962) *The Economy of Cyprus.* One should also note the impressive PhD theses presented by both Apostolides (2010) and Strong (1999), which make an important contribution to our knowledge of economic history in Cyprus during the twentieth century. More recently, Rappas (2014) provides us with a broad-ranging commentary on the colonial position of Cyprus, the local community and relations between them in the 1930s. However, it was the experience of British rule that significantly influenced the development of accounting practice on the island. Thus, Varnava and Clarke (2014) outline the development of accounting practice in Cyprus from the middle of the nineteenth century, when the island was under Ottoman rule, through British 'administration' from 1878 until the end of World War I. Clarke and Varnava (2013) further analysed the four decades from immediately after World War I until Cyprus achieved independence in 1960, which was the era in which notable developments in accounting practice took place on the island.

This paper is structured as follows. In the next section we discuss the background to and context of the imposition of income tax in Cyprus in 1941. The paper then outlines some of the technical provisions of the Income Tax Law introduced at that time. The third section discusses some (unintended) consequences of the initial income tax legislation. The paper ends with a short summary and conclusion.

The Context of the Imposition of Income Tax in Cyprus in 1941

The Ottoman occupation of Cyprus and its subsequent administration by Great Britain provide an initial background and context to this paper. The Ottoman occupation of the island began in 1571 and lasted for about 300 years. Orr (1918) and Hill (1952) inform us that during that time a form of tax on income (*vergi*) was levied on businesses and individuals. However, the proper assessment of business profits, given the absence of business records, resulted in the practice of a subjective assessment of a fixed amount of tax payment according to the nature of a person's business. When this subjective tax was abolished by the British in 1906, its disappearance was hailed with delight by the inhabitants. However, in compensation, tobacco duties were increased (Orr, 1918).

The subsequent British administration of Cyprus, which would last about eight decades, can be formally traced to the Anglo-Turkish Convention of 1878, whereby the Conservative Government of Benjamin Disraeli promised to defend the Ottoman Empire against future Russian aggression. In order to fulfil this military commitment, the administration of Cyprus was ceded to Britain, who occupied the island even though the island's international status remained unchanged (Varnava, 2005). Fairfield (1882) reported on the finances and administration of Cyprus just after the period of British administration began. He warned that no increase in revenue was possible, and that if the overall tax contribution was raised, most of the inhabitants would be driven into the hands of the money lenders beyond the hope of extrication. In addition, it would not be 'credible' for the British to govern as cheaply as their predecessors 'who governed cheaply because they governed badly'. Subsequently, Britain annexed the island on 5 November 1914, in response to the Ottoman Empire entering World War I on Germany's side. Under the Treaty of Lausanne (1923), which was the final treaty concluding World War I and which was signed by representatives of Turkey (successor to the Ottoman Empire), Britain and other countries, Turkey relinquished all rights to Cyprus and recognised British sovereignty over the island. In 1925, Cyprus became a Crown colony: a decision which meant that the British Government had no intention of relinquishing control of the island to Turkey, at least in the short term (Varnava, 2005).

As a Crown colony, a number of reports on Cyprus were commissioned by the colonial authorities. Surridge's (1930) *Survey of Rural Life in Cyprus* provides important statistical information on the living conditions of the rural population, based on interviews conducted in 569 of the island's 641 villages. However, Rappas (2014) argues that the Surridge report is much more than a mere compilation of statistics and figures and should be seen as the first comprehensive ethnographic survey of the island. The *Survey* presented a grim picture of the living conditions of the island's peasantry and it found that up to 25 per cent of the rural population were living below the poverty line with the majority of the island's (agricultural) population being crippled by debt. This report was quickly followed by Oakden's report (1934), which investigated the economic difficulties of the people of Cyprus, and particularly the agricultural classes. Oakden (1934) confirmed Surridge's earlier finding of a social divide caused by money lending, and he also painted a grim picture of the peasantry's living conditions at that time and concluded that farmers could not afford capital investment to improve their productivity (It should be noted that this survey was undertaken during the years of the Great Depression, when agricultural prices were low and Cyprus experienced severe drought.). Both of these reports should be read in the context that Cyprus differed radically from other colonies, in that the allegiances of its population were directed towards two other nation-states, Greece and Turkey, who were not part of the British Empire.

Another report, directly related to the main theme of this paper, dealt with the absence of income tax in Cyprus (Report of the Commission, 1930). The Commission was established to:

> enquire into the present system of taxation, its nature and incidence, with special reference to the condition and interests of agriculture, commerce and industry; to report whether the burden of taxation is equitably distributed and, if not, to make recommendations for its adjustment. (p.5)

In arriving at their conclusions and recommendations, the Commission held 32 meetings, visited all six towns on the island as well as 24 villages in various districts, and examined 153 witnesses. Many of the witnesses 'represented important bodies of manufacturers, traders, professional men, manual workers, agriculturalists, importers and exporters [and the evidence received was] voluminous and fairly exhaustive' (p. 5). The report stated:

> No one who is at all familiar with the existing system of taxation in this Colony will have any doubt as to the difficulty of the task that has confronted us. This difficulty has been accentuated by the reticence of some of the witnesses who, being suspicious of the object of our enquiry, sometimes gave us wrong or misleading information on matters in which they were personally interested, and we have therefore had some difficulty in sifting the accurate from the inaccurate (p. 5).

The Commission estimated that the annual income of the island amounted to about £3.5 million from which about £600,000 in (general) taxation was collected, equivalent to an effective tax rate of 17 per cent. The Commission acknowledged that the current tax levels in Cyprus were at a 'high level' and at a 'point of hardship', and that the underlying expenditure, especially the cost of administration, should be more closely scrutinised in order to allow for 'the development of the Colony in general'. The Commission investigated various methods or bases on which to assess taxes in general. After deliberations, the Commission was ***not*** in favour of an income tax system in Cyprus and argued that such a system:

> cannot be carried beyond a certain point without jeopardy to saving and enterprise. Harm may be done to trade, and, if so, there will be reactions on employment and on the standard of living of the poor (p. 6).

The report also concluded, in a largely unsympathetic manner, that:

> there are still many individuals who are lazy or indifferent and allow their lands to suffer deterioration whilst they sit in cafes passing their time in chatting or playing cards. The cafes of Cyprus, especially in villages, are far too numerous and give temptation to anyone passing by to sit down, start chatting, and soon forget all about his original intention of going out to his fields to work. (p. 7)

The report did not discuss who might have been responsible for this situation in Cyprus, which was a relevant issue given the earlier Surridge (1930) and Oakden (1934) reports. In justifying its rejection of income tax (pp. 8-9), the Commission noted the absence of accounting records in most businesses on the island. To overcome the difficulty of preparing 'accounts' for traders and business, the Commission considered the suggestion that salaried persons (i.e. employees) would be subject to an income tax based on their annual wages, but that traders and other businesses would pay a fixed trade tax according to an estimate made by a Board of Assessors. This proposal, while administratively feasible, was rejected on the grounds that it was inequitable between different groups of taxpayers. The Commission (pp. 8-9) noted that while:

> there is no fairer tax than an income tax we have reluctantly come to the conclusion that it is difficult in the present somewhat backward state of the island in regard to keeping of commercial accounts to impose such a tax [as] there are very few traders who keep proper accounts. This would make it difficult to arrive at their incomes, and it would not be fair to tax those whose incomes could be easily ascertained and allow others to evade taxation. Moreover, uneasiness is felt that examination of books and documents of merchants by a Board of Assessors would result in leakage of information and in certain cases affect the credit of the person whose books have been examined [and the witnesses that provided evidence] agreed that the people would not trust any Board of Assessors appointed from among themselves either as to secretiveness or as to their capability of fair assessment.

To support this argument, two (unnamed) British experts indicated that they knew of 'no country in the world less suitable for the imposition of income tax than Cyprus' (p. 9). After their deliberations the Commission recommended that income tax would not be imposed on Cyprus as it was considered impractical at that time. Later, Sir Ronald Storrs, the Governor of Cyprus wrote (3 February 1932) that 'The [Executive] Council advised that it was impossible without expert experience to gauge the proceeds of an Income Tax or to judge the possibility of profitably applying income tax legislation on Cyprus… the collection of such a tax would be impractical on Cyprus'. However, the seeds for the introduction of an income tax system in Cyprus, and other colonies, had already been sown.

When Joseph Chamberlain took over the Colonial Office in 1895, he stressed the need for colonial development and effective administration of the British colonies, dependencies and protectorates (Levine, 2013). Around that time, the British Empire covered approximately one-quarter of the world's land surface and embraced around the same proportion of humanity (Ferguson, 2012). This considerable geographical spread of empire, with its diversity, suggested the transportation of various types of existing British commercial legislation to the colonies: in modern terms we could describe this process as the 'harmonisation' of legislative systems between countries.

One important piece of legislation concerned income tax, which was reintroduced in Britain in 1842[1] as a peacetime tax in order to finance commercial reforms (Sabine, 1966).

In 1922, an inter-departmental committee was established in London to consider and report on questions relating to the income tax laws in the colonies and protectorates and, if possible, to prepare a Model Ordinance relating to income tax, i.e. rules and procedures for the general use of colonial governments (Inter-Departmental Committee, 1922). A Model Ordinance was drafted after a very careful study and comparison of all the existing colonial income tax Acts and Ordinances, and the committee was:

> of the opinion that uniformity of legislation should be aimed at as far as possible. We think that the easiest and most expeditious means for securing that degree of uniformity which is generally admitted to be desirable will be for the officers responsible for the preparation of Colonial Income Tax legislation to take a single model as the basis on which to work. (p. 5)

The inter-departmental committee recommended that colonial governments, where income tax was already in force, be advised to repeal the existing laws and introduce fresh legislation on the lines of the proposed Model Ordinance, which would be used as a guide by all colonies that may in the future find it necessary to introduce an income tax. One advantage of such a uniform income tax system was that professional income tax assessors of the Revenue could move easily within the British Empire and yet retain their familiarity with income tax legislation in each country or colony. The proposed Model Ordinance represented a simpler income tax system than the legislation then in effect in Britain, and it was this simpler system of income tax that was imposed on Cyprus in 1941.[2] This followed the earlier imposition of an income tax system, with minor variations, in Iraq in 1927, Transjordan in 1933, Egypt in 1938, Hong Kong in 1940, and Palestine in 1941 (Likhovski, 2010). Income tax would also be subsequently imposed on the nearby Mediterranean island of Malta in 1949 (Attard, 2005).

The imposition of income tax on Cyprus is directly attributable to World War II and the resulting economic crisis on the island. For example, there was a possibility of invasion since the island of Crete had already been occupied by the Germans in May 1941 (Thacker, 1954). However, by that time, a memorandum, signed by Attorney

1 The British had introduced income tax in 1799, only to abolish it in 1816 after the Battle of Waterloo. It was reintroduced in 1842 (Income Tax Act).

2 In 1939, the Secretary of State for the Colonies informed the House of Commons (Hansard, 1939) that no income tax applied in a number of territories, including the Bahamas, Bermuda, the Cayman Islands, Cyprus, Gibraltar, Hong Kong, Malaya, Malta, Palestine, Sarawak, Somalialand, Uganda and the Virgin Islands.

General L. Lloyd-Blood (14 December 1939) indicated that an income tax bill was prepared based on the Tanganyika Ordinance of 1932. Thereafter, Italy's entry into the war in the summer of 1940 hindered Cypriot trade and closed most of the normal markets for the colony's produce, with a significant adverse effect on its shipping industry and domestic consumption. However, not all members of Cypriot society struggled financially at that time. Meyer (1962) points out that, in economic terms, the war meant the construction of air bases and air-raid shelters and the transfer of money to local residents, especially via the pockets of soldiers quartered on the island. Therefore, for some Cypriots, the war meant higher incomes, especially for those serving the British military establishment on the island. In addition, it was noted that the many years of immunity from income tax enjoyed by Cyprus had attracted a 'small and leisured class to reside in this island' and such incomes were tax-free (*Cyprus Post*, 7 January 1941).

The advent of income tax was announced in the address of the Governor to the Advisory Council, with the *Cyprus Post* (8 January 1941) noting that unemployment was high 'due to the loss of export markets, the inevitable closing down of the mines [and] the failure to sell much of the agricultural produce of the island'. Introducing income tax was considered to be the most equitable way to eliminate the Government's financial crisis at that time. Budget estimates for Cyprus in 1941 showed total planned expenditure of about £1.1 million compared with estimated revenues of about £850,000, leaving an annual deficit of some £250,000 (*Cyprus Post*, 8 January 1941). The London *Daily Express* newspaper (29 March 1941) reported that the average yearly income for a husband and wife in Cyprus was £50 and that the new tax would probably apply to no more than 5,000 people.

Some Features of the Income Tax Legislation in 1941

The legislation that imposed income tax in Cyprus (Income Tax Law, 1941) contained just 59 Sections and was remarkably simple relative to present-day legislation. The essential thrust of the legislation was that income tax was payable in respect of the gains or profits from any trade, business, profession, vocation or employment, but it also applied to income received from dividends, interest, pensions, rents and royalties. The legislation provided that: 'tax shall be charged, levied and collected for each year of assessment upon the chargeable income of any person for the year immediately preceding the year of assessment' (S. 6). Thus, the first year of assessment (1941) was based on income arising during 1940, and this is frequently described as the 'previous year basis of assessment'. This 'previous year basis of assessment' made it easier to assess income tax in a given year, because the income tax assessment was based on the known income of the previous year.

Five aspects of the Income Tax Law (1941) will now be outlined, namely (i) expenses allowed in computing taxable income for businesses, (ii) income tax rates, (iii) tax avoidance provisions, (iv) matters relating to compliance and (v) personal deductions and allowances.

(i) Expenses allowed in computing taxable income for businesses

Based on the Model Ordinance and prior British legislation, the Income Tax Law, 1941 (S. 10) allowed the deduction of 'all outgoings and expenses *wholly and exclusively* [emphasis added] incurred during the year' in ascertaining taxable income. This 'wholly and exclusively' test for expense deductions – which still exists in legislation – is one of the most commonly known phrases in the world of income tax practice and was included in the 1842 (UK) legislation (Income Tax Act, 1842). The practical implication of this provision was that if a business incurred an expense, but could not prove that such an expense was 'wholly and exclusively' incurred for the purpose of the business, that expense would not be allowed as an income tax deduction. (This 'wholly and exclusively' test remains a frequent source of dispute between the income tax authorities and businesses, and often requires the assistance of professional tax agents engaged by the taxpayer). On the other hand, expenses that would routinely be allowed as legitimate deductions for income tax included, for example, repairs to premises, and plant and machinery used in generating the income during the financial year. Allowable expenses also included bad debts incurred in any trade, business, profession or vocation proved to the satisfaction of the Commissioner to have become bad during the year. However, a provision for bad debts was not allowed as the expense was not yet incurred.

The legislation also provided (S. 53) that expense deductions would not be allowed unless proper accounts, which were to the satisfaction of the Commissioner, were produced. In the first Income Tax Report (Commission on Income Tax,1941 and 1942) it was explained that the introduction of this special Section (i.e. S. 53) was designed to meet the difficulties arising from the deplorable state of bookkeeping and accountancy in Cyprus, and that in the first year it had been of appreciable value and was expected to prove increasingly useful in future years. In addition, the legislation (S. 43 i) required that where a taxpayer appealed their assessment, the Commissioner 'may require the person giving the notice of objection…to produce any accounts, books or other documents in his custody or under his control…relating to such income.'

The legislation (S. 12) also specified that deductions were NOT to be allowed in computing taxable income in respect of, for example:

A. Domestic or private expenses including the cost of travelling between residence and place of business

B. Any 'drawings' by the owner, including the cost price of any goods taken out of the business by the owner

C. The cost of any improvement

The above provisions provided a significant incentive to businesses to improve their bookkeeping and accounting procedures. Furthermore, it may have been advantageous to avail of the services of professional accounting and taxation practitioners. This theme will be discussed in the next section of this paper.

(ii) Income tax rates

The Income Tax Law, 1941 applied to the income/profits of both individuals and corporate bodies (Legislation relating to corporate bodies had been introduced in Cyprus (Companies (Limited Liability) Law, 1922). However, there was an important distinction made in the Income Tax Law: income tax was levied on individuals at progressive rates whereas income tax was imposed on limited liability companies at a single flat rate. Thus, the 1941 income tax legislation provided that individuals with chargeable income of less than £150 per annum were exempt from income tax, while those with chargeable incomes between £150 and £175 were liable to a £1 income tax levy, individuals with chargeable incomes between £175 and £200 paid a levy of £1.10*s*.0*d*., and so forth. The top rate of income tax, on chargeable incomes in excess of £5,000, was levied at 60 per cent. (The legislation provided a 'ready reckoner' for income tax payable.) This graduated system of personal income tax had already been in existence in Great Britain for many years and had been recommended by the Model Ordinance (Inter-Departmental Committee, 1922). In contrast, companies were liable to a flat rate of tax of 'three shillings and three piastres in every pound of chargeable income' – equivalent to an effective tax rate of about 15 per cent. This flat rate system of income tax on companies had been recommended by the 1922 Report (Inter-Departmental Committee), who found 'no sufficient reason for graduating the rate of tax payable by companies according to the amount of profits they make' (p. 11). This difference in income tax rates between individuals and limited liability companies underlined the necessity of good tax advice in deciding to carry on business as a limited liability entity or as a sole trader (or partnership), so as to minimise income tax burdens.

(iii) Tax avoidance provisions

Tax avoidance can be generally defined as the legal utilisation of tax law to a taxpayer's own advantage, in order to reduce the tax that would otherwise be payable. The legality of tax avoidance had been clearly articulated in the United Kingdom in the *IRC v. Duke of Westminster* case (1936). During that case it was revealed that the

Duke had stopped paying non-deductible wages to his (private) employees but had, instead, paid them by way of an annual covenant which was deductible for income tax purposes. Lord Tomlin's dictum in the *Duke of Westminster* case is now one of the most famous quotations in taxation history:

> Every man is entitled if he can do to order his affairs so as that the tax attaching under the appropriate Acts is less than it otherwise would be. If he succeeds in ordering them so as to secure this result, then, however unappreciative the Commissioners of Inland Revenue or his fellow taxpayers may be of his ingenuity, he cannot be compelled to pay an increased tax.The Cyprus Income Tax Law of 1941 contained both specific and general anti-avoidance provisions. The specific anti-avoidance provision (S. 44 i) was targeted at limited liability companies, which were controlled by not more than five persons, i.e. small family companies. This provision allowed the Commissioner to treat the undistributed profits of such companies as a dividend, where a dividend 'could be distributed to shareholders without detriment to the company's existing business or without detriment to the future expansion or development of the Company's business' (It is interesting to stress that this, literal, application required an understanding of the current position and proposed future developments of the company.). Thus, it is not surprising that the Memorandum made many recommendations regarding this subjective anti-avoidance provision, which applied to most companies in Cyprus, simply because they were mainly family-controlled entities.

The practical implication of this (subjective) Section meant that individual shareholders of a (family) company could be assessed to income tax ***as if*** they were in receipt of dividends from their company, even though no dividend was actually received by a shareholder. (It should be recalled that companies at that time were assessed to income tax at an approximate flat rate of 15 per cent, whereas high-income individuals could be liable to an income tax rate of 60 per cent.) Therefore, without such a specific anti-avoidance Section, shareholders of small, family companies had the incentive to retain profits within the company rather than pay out profits to its shareholders, which would have been taxed at progressively higher income tax rates. Thus, a corporate structure became an immediate tax shelter for profitable family companies. (Nevertheless, family shareholders would still have had access to the company's profits by the simple expedient of utilising loan accounts with the company, which were not liable to income tax). However, the practical impact of this anti-avoidance provision was that shareholders would not be able to avoid paying income tax on 'undistributed' profits of small, family companies. Thacker (1954) points out that this provision was applied to every British colony, including the Virgin Islands, which had a total population of 7,300 persons.

The Income Tax Law also contained a general anti-avoidance provision (S.44 ii), which provided that 'where the Commissioner is of the ***opinion*** (emphasis added) that any transaction which reduces or would reduce the amount of income tax payable by any person is artificial or fictitious he may disregard any such transaction, and the persons concerned shall be assessable accordingly'. This general anti-avoidance provision represented a most powerful pre-emptive approach to the practice of tax avoidance. In simple terms, it allowed the Income Tax Commissioners to deny a tax advantage to a taxpayer if the perceived purpose of a transaction was primarily to avoid paying income tax and was considered to be 'artificial'. It should be appreciated that this (subjective) anti-avoidance Section had the potential to cause extreme difficulties for taxpayers in interpreting the income tax code. However, Cyprus was not alone in introducing this anti-avoidance Section: similar general anti-avoidance provisions also existed in the income tax legislations of other British colonies and dominions such as Australia, Canada, Palestine and South Africa (Likhovski, 2010). This general anti-avoidance provision can be traced back to the Excess Profits Duty legislation (Finance (No. 2) Act, 1915), which stipulated (S. 44 iii) that 'a person shall not, for the purpose of avoiding the payment of excess profits duty, enter into any fictitious or artificial operation'.

(iv) Matters relating to compliance

In relation to compliance with income tax regulations, the onus was placed on individual taxpayers to contact the Commissioner in relation to liability. Section 29 provided that 'it shall be the duty of every person chargeable with tax to give notice to the Commissioner by the prescribed date in any year of assessment that he is so chargeable' and an explanatory note to the income tax legislation indicated that there was an obligation upon all persons whose income for the year ended 1940 exceeded £150, under a penalty for neglect, to give notice to the Commissioner of Income Tax by the prescribed date that he is chargeable with tax (*Cyprus Gazette*, 26 March 1941). A subsequent notice in the *Cyprus Gazette* (19 April 1941) highlighted that the prescribed date was 30 April 1941 and that such notices should be in the following form and should be written clearly in block letters:

To: The Commissioner of Income Tax, 6, Edward VII Road, Nicosia

I hereby give notice that I am chargeable with Income Tax in respect of my income for the year 1940 and forward the undermentioned particulars for your information. (Signed) ....

Particulars.............

Full Name.............

Full Business Address (if any) and nature of business or profession..............

Full Residential Address................

Occupation (if any) with name and address of employer..........

There were penalties for non-compliance and for making false income tax returns. The legislation provided (S 43 ii) that 'any person who, without lawful excuse, fails or neglects to furnish such particulars or to attend and produce such accounts, books or other documents … or knowingly gives any false evidence … shall be guilty of an offence against this Law'. Moreover, any person who 'knowingly makes any false statement or false representations [or any person] who aids, abets, assists, counsels, incites or induces another person' to make false returns would be liable, on conviction, to a fine not exceeding £100 and treble the amount of tax (S. 54). In default of such payment, the guilty person would face imprisonment for 'any term not exceeding six months' (S. 56).

(v) Personal deductions and allowances

The 1941 Income Tax Law made no provision for deductions in respect of dependent children, i.e. children under 16 years of age. Neither could deductions be claimed in respect of payments for life assurance premiums and contributions to pensions, even though these were contained in the Model Ordinance. The Income Tax Report (1941 and 1942) explained this omission by indicating that various departures from the Model Income Tax Ordinance, 1922 were made 'to meet, as far as possible, the specific difficulties in Cyprus particularly in the introductory years… and all allowances were omitted for the following reasons:

A. in the interests of simplicity of administration in the first year;
B. the comparatively high exemption limit;
C. the desirability of having some *palliatives* [emphasis added] in reserve if the rate of tax is increased, which it no doubt will be."

The operation of the new income tax in Cyprus was summarised in a letter by Governor Woolley (1941) as follows: 'during the first year of operation this Law, which introduced income tax in Cyprus for the first time, has proved remarkably simple and efficient in operation. It has worked with smoothness and the minimum of friction, and has occasioned negligible criticism and complaint from the public'. The Income Tax Report (1941 and 1942) remarked that 'the absence of personal allowances for children and life assurance…enabled the return (of income) forms to be of maximum simplicity'. The Income Tax Report (1941 and 1942) further indicated that the yield from income tax was £99,000 and £151,000 for the financial years 1941 and 1942 respectively, based on the previous year of assessment (It was noted that the actual income tax yield for 1941 compared well with the original estimate of £50,000).

Return forms were issued to 3,017 cases, of which 307 turned out to be exempt. There were 184 objections to the Commissioner, almost entirely on the grounds of excessive assessment, and of these, 64 obtained some reduction. The total cost of administration and collection amounted to £2,079 and £2,490 for 1941 and 1942 respectively, with staff salaries (and bonuses) representing about 90 per cent of these amounts and the balance consisting of rent and travel expenses. The staff consisted of one Supervisor of Income Tax, one Chief Clerk, five clerks, one temporary clerk and one messenger (Income Tax Report, 1941 and 1942).

Subsequently, some changes were made to the original legislation. For example, the Income Tax (Amendment No. 1) Law, 1942 introduced deductions (S. 5), amounting to £25 for dependent children, i.e. under 16 years of age, or who were receiving full-time instruction at any university, college, school or other educational establishment. The expression 'child' in the legislation included a stepchild but did not include an adopted or illegitimate child. There was no deduction if the child earned £25 per annum, but this amount excluded scholarship or bursary funds received. No deduction was allowed for more than three children, but this restriction was removed in 1952. In 1953, a deduction of up to £250 could be claimed on expenditure for children being educated outside the colony, which Thacker (1954) points out discriminated unfairly against the less wealthy parents who sent their children to secondary schools in Cyprus. In addition, deductions were introduced for life assurance premiums payable on the taxpayer or his wife, but they were limited to seven per cent of the capital sum insured and restricted, in total, to 1/6 of the taxpayer's total income. The calculation of these deductions added complexity to the income tax system.

We shall argue in the next section that the introduction of income tax in 1941 in Cyprus had a number of important consequences, not all of which were intended.

Some Consequences of the Income Tax Legislation

Several important consequences can be attributed to the imposition of income tax in Cyprus. First, as with Great Britain itself, income tax would become an important source of government revenue and, over the years, it was assessed on an increasing number of individual taxpayers in Cyprus. The Comptroller of Inland Revenue (1949) revealed that approximately 15,000 persons paid income tax in Cyprus, with 12 persons having chargeable incomes between £4,000–£6,000 and eight persons having chargeable incomes in excess of £6,000. Thacker (1954) presents the total of income tax collection from 1941 to 1953 (Table 1) and points out that in 1941 it generated about nine per cent of the colony's total revenue, which increased to about 35 per cent within a decade. The income tax collection system was made more efficient and effective by the introduction of a Pay As You Earn (PAYE) system, with effect from 1 January 1953, under which income tax is deducted from wages and salaries and accounted for by the employer.

Table 1: Income Tax Collections in Cyprus (1941 – 1953)

1941	£99,000	1948	£967,000
1942	£150,000	1949	£883,000
1943	£304,000	1950	£1,193,000
1944	£542,000	1951	£2,006,000
1945	£536,000	1952	£2,839,000
1946	£489,000	1953	£3,362,000
1947	£600,000		

The importance of income tax receipts to the Government of Cyprus continues to the present time, with current statistics indicating that about one-third of total tax revenue collected in Cyprus is generated from the direct taxation of individuals and corporations (Eurostat, 2015). Thus, while the introduction of income tax in Cyprus was purely a wartime expedience, its financial contribution is now so significant that its abolition can never be seriously contemplated by any responsible government.

Second, administration of the income tax legislation required accounting and bookkeeping expertise among officials within the Inland Revenue Department in order to operate the assessment and collection of income tax in an orderly fashion. Throughout the 1940s, advertisements appeared in the local press offering attractive job opportunities for appropriately qualified individuals. For example, one advertisement for the Inland Revenue Department (*Cyprus Gazette*, 2 December 1943) invited applications for three posts of assessors and one accountant. The advertisement stipulated that candidates should possess an accounting qualification and must have good knowledge of the English language. The importance of the English language on the island, for administration, commercial and social reasons, had been identified some years earlier. For example, a special report on educational subjects noted that 'there is a growing recognition among the educated Cypriots of the importance of a knowledge of the English language, both because it is one of the official languages of the country and for practical purposes of commerce. According to estimates made in 1901, only about 650 of the native population can be said to speak English' (Board of Education, 1905, p. 424). Some years earlier, in 1880, the Reverend Spencer had founded an English school at Nicosia 'for adult males interested in obtaining employment in the colonial government' (Demetriadou, 2012). Subsequently, a government examination in English for officials and those desirous of entering the civil service had been established and was held annually. The exam included translation, dictation and conversation, to which special importance was attached (Board of Education, 1905). In simple terms, knowledge of the English language, especially if it was augmented with appropriate accounting skills, was an important source of social mobility in Cypriot society.

Third, it is logical to suggest that some income taxpayers, both individuals and companies, also required the services of income tax professionals who had adequate knowledge of the technical provisions of the income tax legislation. This represents the 'demand' for income tax professionals. Some technical aspects of the Income Tax Law have been outlined in the previous section, which include, for example, the deduction of only 'wholly and exclusively' expenses, the important implications associated with the business structure as a sole trader or limited liability company, coping with anti-avoidance provisions, and general matters relating to compliance. Clearly, the services of a professional tax agent would be beneficial for the taxpayer, especially for preparing business accounts and income tax computations (see Appendix 2 for an income tax computation for a trader). The Income Tax Law was an innovative piece of technical legislation for the majority of income tax payers in Cyprus. At that time, very few individuals in Cyprus would have had any previous knowledge of income tax and, as a result, many would have found aspects of the legislation rather complex. Access to these professional services would allow the taxpayer to comply with this unprecedented legislation, and, where appropriate, to prove the taxpayer's circumstances to the 'satisfaction of the Commissioner'. Thus, accounting and tax professionals became a useful link in the negotiation process between the tax authorities and taxpayers. Indeed, a former income tax assessor, interviewed as part of this study, opined that taxpayers would be likely to consult their tax advisers when dealing with the Inland Revenue and that a good living could be earned by those who represented their clients' interests (Papakyriacou, 2011).

Thus it is not surprising that the first formal explanation of Cypriot income taxation appeared soon after the income tax legislation was introduced, and included worked examples in English and Greek (Antoniades,[3] 1941, p. 42). Translated into English the title was *Income Tax in Cyprus: Complete Translation of the Law, Explanation and Meaning of the Law.* Antoniades revealed (in translation) that he had graduated from Montpellier and Liege Universities with a degree in economics and management and was a member of the Royal Economics Society of England (see Appendix 1). He intended that his publication would be used by tradesmen, accountants, lawyers and taxpayers. Antoniades' (1941) pamphlet (in Greek and English) contained several examples of income tax computations for individuals and for those in business.

3 This publication is available in the British Library and also in the Archbishop Makarios III Foundation Library in Nicosia. It was printed in 1941 but is bound with a supplement (Supplement No. 1), published in 1942, which gives the text of the 1942 amended Income Tax Law in Cyprus.

Subsequently, Mr Antoniades, who was not a qualified accountant, formed his own professional accountancy firm, which is the second oldest accountancy firm in Cyprus and is now part of Grant Thornton (Michaelides, 2010). The (translated) Preface states:

> examples that we use were taken from the everyday life of Cyprus (and) in our effort to make this project even more complete we have drawn help from studying and consulting various English, Greek and other studies relevant to the subject … Allow us to mention that, as far as we know, this is the first time that a law is being translated by a private individual and also that this is the first time that a law is being discussed, analysed and explained.

It should also be noted that when Cyprus introduced a Pay As You Earn (PAYE) system, with effect from 1 January 1953, it adopted the non-cumulative PAYE system. Unlike the 'cumulative' PAYE system, which applied in the United Kingdom, the non-cumulative system was less accurate, for technical reasons, in deducting tax from employees. Thus, taxpayers who paid their income tax under the PAYE system may have been entitled to an end-of-year refund of income tax previously deducted during the tax year. However, to recognise that a repayment of income tax at year end was due, the taxpayer would have required some knowledge of the PAYE system with its menu of tax deductions and allowances, or access to a professional adviser.

This 'demand' for income tax professionals and professional accountants should also be considered in conjunction with legislation relating to Estate Duty and Company Law enacted in Cyprus around that time. The Estate Duty Law (1942) imposed a tax on the estate of every person dying on or after 1 December 1942 who, at the time of death, was domiciled in Cyprus. In the case of deceased persons who were not domiciled in Cyprus, the estate duty tax was imposed on all property in Cyprus that passed on death. All property passing on death, including business interests, was required to be valued and returns to be made by the executor of the estate (It should be noted that the valuation of a business interest required appropriate accounting skills.). There were stiff penalties for making incorrect statements, or not making statements when they were required.

In addition, the Companies Law (1951), which replaced the 1922 legislation, brought some accounting changes to Cyprus. This new companies legislation was announced in the Governor's 1951 Budget address and indicated that the (pending) Companies Law would 'bring the law in Cyprus into line with the law regarding companies in the United Kingdom' (*Cyprus Mail*, 31 January 1951). This legislation required, *inter alia*, that, subject to certain exceptions, company auditors must be members of professional accountancy bodies established in the United Kingdom and Ireland. Thus, the introduction of income tax, estate duty and the new company legislation provided an important stimulus for the growth of professionally qualified accountants in Cyprus. By the mid-1950s a small number of qualified accounting professionals, who had obtained their professional accountancy qualifications in England just after World War II, had professional accounting and tax offices in Cyprus. Efforts to form a local professional accountancy body in Cyprus, delayed through the emergency period (1955–1959), were finally successful when the local Institute of Certified Public Accountants of Cyprus was finally established in 1961. The Institute continues to thrive (Clarke, 2011).

The final important consequence of the imposition of income tax on Cyprus in 1941 relates to the new Constitution of the emerging independent Republic of Cyprus. Article 78 of that Constitution provided that 'the adoption of any law relating to the municipalities and of any law imposing duties or taxes shall require a separate simple majority of the Representatives elected by the Greek and the Turkish communities respectively taking part in the vote'. In other words, separate majorities were required in the House of Representatives for the imposition or amendment of income tax legislation. In a critical manner, Weston Markides and Holland (2001) argue that this provision, while it was intended to prevent discrimination against the Turkish Cypriots, meant that the island could be 'held to ransom' by Turkish representatives vetoing tax laws. Thus, it is important to note that, post-independence, there were several disagreements between the Greek Cypriot and Turkish Cypriot communities. One of these disagreements soon arose in relation to income tax and it can be argued that opposing attitudes on both sides of the political divide widened between the island's two communities.

According to Hollmeister (2006), under article 188 (2) of the Constitution, the British law on income tax was to stay in force until 31 December 1960. Thus, new Cypriot income tax legislation was required but needed the consensus of both communities in Parliament. This was not forthcoming. Swan (1984) notes that the 31 March 1961 House vote on a three-month extension of income tax found 25 Greek Cypriot representatives in favour but 11 Turkish Cypriot representatives opposed. As a result, the bill failed because it lacked an Article 78 (2) concurrent majority. Swan (1984) also notes that this fundamental disagreement must be viewed against the background that Turkish Cypriots during the 1960s contributed some nine per cent of the income tax paid into the Treasury, whereas Greek Cypriots and others paid the remaining 91 per cent. Rauf Denktash, President of the Turkish Communal Chamber, called on Turkish Cypriots to cease paying taxes to the Republic (*Middle East Record*, 1961). In contrast, Swan (1984) indicates that the President of the House of Representatives, Glafcos Clerides, argued on 18 December 1961: 'Surely the income from this tax, which comes mainly from the well-to-do Cypriot classes, will be used to cover expenses of the five year plan, which plan will benefit not only the Greeks or the Turks but Cyprus as a whole'. In January 1962, President Makarios announced that since the Turkish Cypriots were abusing the special rights given to them by the Constitution, he was obliged to disregard and seek revision of those provisions which obstructed the functioning of the State (Weston Markides and Holland, 2001). Thus, the income tax legislation imposed by the British on the island of Cyprus in 1941 was now part of the fiscal narrative, along with other important issues, that would drive the island's two communities apart rather than encourage reconciliation.

Concluding Remarks

This paper has presented the context of the imposition of income tax on Cyprus in 1941. It has outlined the various factors and events that influenced the imposition of income tax in Cyprus in 1941 and identified the more obvious and important consequences. However, a pioneering paper like this has its limitations, and one limitation stems from the lack of research that has been published in English on this topic. However, this limitation represents a considerable opportunity for other researchers. In addition, this paper focuses on the introduction of income tax in Cyprus in 1941 and the two decades thereafter. It may be appropriate for other researchers to subsequently investigate more specific periods and/or specific events so that a fuller analysis and history can be compiled. Another limitation is that this paper has not adopted a conceptual framework or 'distinctive lens' through which to view developments over time, and therefore premature generalisations may be drawn. However, it should be pointed out that the choice of a conceptual framework is a very subjective one for the researcher. Indeed, it can be argued that the choice of a conceptual framework is more relevant and appropriate when the field of study is better explored and developed.

Sabine (1966) has pointed out that the introduction of income tax in Britain in 1799 was a wartime expedient. This was also the situation for the British colony of Cyprus. The many technical provisions contained in the Income Tax Law (1941) were new to the taxpayers of Cyprus and there were stiff penalties for non-compliance. The imposition of income tax in Cyprus generated additional revenue for the Government and continues to do so to the present time. Current statistics indicate that about one-third of total tax revenue collected in Cyprus is generated from the direct taxation of income of individuals and corporations (Eurostat, 2015). There were other consequences to the introduction of income tax in Cyprus. The administration of income tax would provide good employment opportunities and career progress for those well-versed in income taxation provisions and procedures, and related legislation, and who spoke English. Some of these accountancy professionals were influential in the formation of the Institute of Certified Public Accountants in Cyprus in 1961. However, one (unintended) consequence was that, after independence was achieved in

1960, the administration of income tax further fuelled certain divisions, rather than reconciliation, between two of the local communities on the island.

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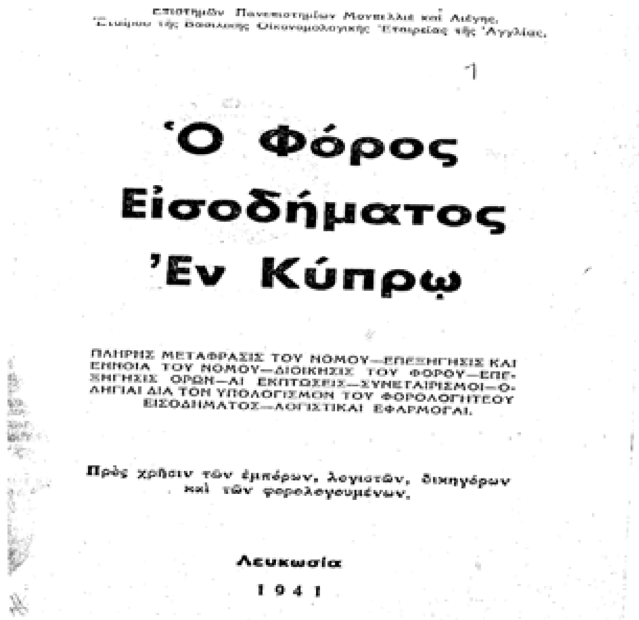
Appendix 1



Ἐπιστημῶν Πανεπιστημίων Μονπελλιέ καὶ Λιέγης.
Ἑταίρου τῆς Βασιλικῆς Οἰκονομολογικῆς Ἑταιρείας τῆς Ἀγγλίας.

1

Ὁ Φόρος Εἰσοδήματος Ἐν Κύπρῳ

ΠΛΗΡΗΣ ΜΕΤΑΦΡΑΣΙΣ ΤΟΥ ΝΟΜΟΥ—ΕΠΕΞΗΓΗΣΙΣ ΚΑΙ ΕΝΝΟΙΑ ΤΟΥ ΝΟΜΟΥ—ΔΙΟΙΚΗΣΙΣ ΤΟΥ ΦΟΡΟΥ—ΕΠΕΞΗΓΗΣΙΣ ΟΡΩΝ—ΑΙ ΕΚΠΤΩΣΕΙΣ—ΣΥΝΕΤΑΙΡΙΣΜΟΙ—ΟΔΗΓΙΑΙ ΔΙΑ ΤΟΝ ΥΠΟΛΟΓΙΣΜΟΝ ΤΟΥ ΦΟΡΟΛΟΓΗΤΕΟΥ ΕΙΣΟΔΗΜΑΤΟΣ—ΛΟΓΙΣΤΙΚΑΙ ΕΦΑΡΜΟΓΑΙ.

Πρὸς χρῆσιν τῶν ἐμπόρων, λογιστῶν, δικηγόρων καὶ τῶν φορολογουμένων.

Λευκωσία

1941

Acknowledgement: Archbishop Makarios III Foundation Library, Nicosia, Cyprus

Appendix 2

Example of income tax computation for a business

Note: Some figures have been amalgamated by this author to provide clarity, and modern terminology rather than literal translations are used.

Profit and Loss for the year ended 31 December, 1940

	£		£
Wages	50	Gross profit from trading	1,945
Rent	60		
General expenses	90	Interest received	50
Salaries	160		
Repairs	20	Rent received	70
Bad debts written off	40		
Provision for bad debts	60		
Salary of owner	240		
Income tax	19		
Miscellaneous expenses	4		
Land tax	3		
Donations to charity	10		
Overtime pay	9		
Depreciation (various)	38		
Net profit	1,262		
	2,065		2,065

The income tax computation was then prepared. The profit and loss account showed a net profit of £1,262, but became £1,629 as per the income tax computation, as follows:

Income Tax Computation

Net profit from profit and loss account (above)	1,262
Add back: Disallowable expenses	
Provision for bad debts	60
Salary of owner	240
Income tax	19
Donation to charity	10
Depreciation	38
= Taxable profit	1,629

Source: Antoniades (1941, 42), as amended by author