

IN THE HIGH COURT OF SINDH AT KARACHI

Present:

Mr. Justice Mohammad Abdur Rahman

Mr. Justice Dr. Shah Nawaz Memon

Spl. Sales Tax Reference Application No. 2508 of 2015

M/s. Shahbaz Garments (Pvt) Ltd. Karachi VS Commissioner of Inland Revenue LTU, Karachi

Spl. Sales Tax Reference Application No. 2509 of 2015

M/s. Shahbaz Garments (Pvt) Ltd. Karachi VS Commissioner of Inland Revenue LTU, Karachi

Dates of hearing: 24.09.2026, 25.09.2026 & 28.09.2026

Date of decision: 02.10.2026

Applicants: Through Mr. Abid H. Shaban alongwith Ms. Naveeda Basharat, Advocate.

Respondents: Through Mr. Asad Aftab Solangi, Advocate (in SSTR No. 2508/2015) & Mr. Mukesh Kumar, Advocate (in SSTR No. 2509/2015)

J U D G M E N T

DR. SHAH NAWAZ MEMON, J.: — These two reference applications under section 47 of the Sales Tax Act, 1990 (the “Act”) are directed against a common order dated 07.08.2015 of the learned Appellate Tribunal Inland Revenue, Karachi (the “Tribunal”) in STA Nos. 126/KB/2012 and 127/KB/2012. They concern the same registered person, the same question of law and two consecutive periods, and are decided together by this judgment.

I. FACTS OF THE CASE

2. The applicant is a private limited company registered under the Act as a manufacturer and exporter of industrial gloves, and during the periods in question it stood on the rolls of the Large Taxpayers Unit, Karachi. The Sales Tax Special Procedure (Withholding)

- Rules, 2007 (the “Rules”) were made by the Federal Government through S.R.O. 660(I)/2007 of 30.06.2007, principally in exercise of the powers under sub-sections (6) and (7) of section 3 of the Act.¹ Sub-rule (3B) of rule 2, added by S.R.O. 704(I)/2009 of 30.07.2009, required a registered person in the Large Taxpayers Unit, purchasing goods from a registered person outside that Unit, to deduct and withhold one per cent of the value of the taxable supply from the payment due to the supplier and to deposit that amount through its own monthly return.²
3. On audit it was found that the applicant had not withheld the one per cent on its purchases from suppliers outside the Large Taxpayers Unit. For July 2009 to June 2010 (the subject of the reference No. 2509 of 2015), a show cause notice dated 02.01.2012 stated that Rs.623,912 was “recoverable from you under Section 36(1)” with default surcharge, and the order-in-original No. 07/58 of 2012 dated 25.02.2012, passed “under section 11(2) read with 36(1)”, held that amount “recoverable from the registered person u/s. 11” with default surcharge and penalty. For July 2010 to June 2011 (the subject of the reference No. 2508 of 2015), a show cause notice dated 25.01.2012 described Rs.2,644,523 as “recoverable from you under Section 11(1)” and asked why it should not be “recovered from them under section 36(1)”. After reconciliation of purchases from registered persons within the Large Taxpayers Unit and of excluded purchases, the order-in-original dated 15.03.2012 required the applicant to pay

¹Section 3(6) and (7), as they then stood: “(6) The Federal Government or the Board may, in lieu of the tax under sub-section (1), by notification in the official Gazette, levy and collect such amount of tax as it may deem fit on any supplies or class of supplies or on any goods or class of goods and may also specify the mode, manner or time of payment of such amount of tax. (7) The Federal Government may, by notification in the official Gazette, specify any person or class of persons as withholding agent for the purpose of deduction and deposit of tax at the specified rate in such manner and subject to such conditions or restrictions as the Federal Government may prescribe in this behalf.” The preamble to the Rules also refers to section 7(4) and section 8(1)(b), read with section 71.

²Rule 2(3B), as reproduced in the order-in-original of 25.02.2012: “(3B) Notwithstanding anything contained in sub-rule (3) or (3A), a registered person in a Large Taxpayer Unit (LTU), who purchases goods from registered person, other than one registered in LTU, shall deduct and withhold 1% of value of taxable supply received by him as Sales Tax from payment dues from the suppliers this amount will be deposited by the withholding agent through his monthly return. Remaining amount of 15% or more, as the case may be of the value of taxable supplies shall be paid by the withholding agents, to supplier who will account for that in his monthly return.” The memorandum of reference refers to it as rule 3(3B). The sub-rule was omitted by S.R.O. 98(I)/2013 of 14.02.2013.

Rs.1,175,004 with default surcharge “in terms of sections 11(1), 36(1) and 34”, and imposed a penalty of Rs.58,750.

4. At each stage the applicant did not dispute that it had not withheld. Its answer was that its suppliers had paid their full output tax, including the one per cent not withheld; it placed the suppliers’ returns on record for the greater part of each amount and asked the department to verify the balance from its own records. It objected that it had been charged under section 36(1) without any statement of why that provision applied, and it maintained, in its replies and again in its grounds of appeal, that neither the Act nor the Rules provided for recovery from the purchaser of tax which it had not withheld. The assessing officers treated the payment by the suppliers as beside the point.
5. The learned Commissioner Inland Revenue (Appeals-III), Karachi, by orders dated 02.06.2012, accepted that the suppliers had discharged the tax, held that its recovery once more from the applicant would tax the same transaction twice, and deleted the principal amounts and the default surcharge. Treating the default as a procedural lapse, he retained a penalty at five per cent, that is Rs.31,195 for 2009-10 and Rs.58,750 for 2010-11. The applicant accepted those orders.
6. On the department’s appeals, the learned Tribunal, by its common order dated 07.08.2015, held that “the levy represents sales tax as envisaged in Sales Tax Special Procedure Withholding Rules, 2007 and there is no evidence whatsoever that the impugned of sales tax was voluntarily and additionally paid by the purchasers”, accepted the submission that the recovery of withholding tax under the income tax and sales tax laws “would differentiate on all four corners”, and vacated the orders of the learned Commissioner (Appeals) on this issue. These references followed.

II. THE QUESTIONS PROPOSED

7. Seven questions are proposed in each reference, identical save for the figures. The first two allege a misreading of the record; the third asks whether withholding of one per cent, over and above the

tax already paid by the suppliers, exceeds the rate provided in section 3; the fourth, fifth and sixth ask whether the default was no more than a procedural lapse and whether the scheme of the Act and of section 3 was correctly understood. The seventh question reads:

“7) Whether in facts and circumstances of the case and in law, the learned Appellate Tribunal Inland Revenue was right to uphold the action initiated u/s 11 of the Sales tax Act 1990 for non-withholding of tax under Sales Tax Special Procedure (Withholding) Rules, 2007 and recovery thereof?”

8. When the references were first heard in April 2017, learned counsel for the applicant asked that question (3) be taken up and also questioned the vires of sub-rule (3B). It was then noted that the provision of the Act under which the recovery had been made, and the effect of sub-rule (3B), had not been examined by the forums below.

III. SUBMISSIONS

9. Learned counsel for the applicant submitted that the suppliers had paid their tax in full, so that recovering the same one per cent from the applicant would collect the tax twice; that the default was at the most a procedural lapse, for which the applicant had accepted the penalty; and that the learned Tribunal did not consider the evidence of payment by the suppliers. His principal submission was that no provision of the Act, as it stood during these periods, permitted the recovery from a purchaser of tax which he had not withheld. In support he relied on *Allama Iqbal Open University*,³ where the Supreme Court held that such recovery became possible only with the insertion of section 11(4A) by the Finance Act, 2016.
10. Learned counsel for the department, in both references, supported the order of the learned Tribunal. They submitted that the Rules cast on the applicant a duty to deduct and deposit which did not

³*Allama Iqbal Open University v. Commissioner Inland Revenue* [2026 SCMR 141]. The Lahore High Court has since applied it in *Shahzaib Brothers Paper Cone* [2026 PTD 991].

depend on what the suppliers did, and that the tax not withheld could be levied and recovered from the applicant under section 36 of the Act, as it then stood, which is the provision on which both show cause notices were founded.

IV. THE PROVISION FOR RECOVERY

11. Question (7) goes to the root of both references and we take it first. It asks, in substance, under which provision of the Act the amounts could be recovered from the applicant. The duty to withhold and the power to recover what was not withheld are two different things. That the Rules required the applicant to deduct and deposit the one per cent is not in doubt, and it has never been disputed. But a demand for tax, with default surcharge, must rest on a provision of the Act that authorises the officer to determine the amount and to recover it from the person against whom he proceeds. The Rules did not themselves say what was to follow a failure to withhold. Rule 6 did no more than apply the other rules and notifications under the Act to the supplies covered, so far as consistent with the Rules.⁴
12. The orders-in-original rest on sections 11(1), 11(2) and 36(1) as they then stood.⁵ Section 11(1) concerned a person who fails to

⁴Rule 6: "All the provisions of the rules and notifications made or issued under the Sales Tax Act, 1990, shall apply to supplies as aforesaid not inconsistent with the provisions of these rules."

⁵Section 11(1) and (2), as they stood when the show cause notices were issued and the orders-in-original passed, and until section 11 was substituted by the Finance Act, 2012 (XVII of 2012): "(1) Where a person who is required to file a tax return fails to file the return for a tax period by the due date or pays an amount which, for some miscalculation is less than the amount of tax actually payable, an officer of Inland Revenue shall, after a notice to show cause to such person, make an order for assessment of tax, including imposition of penalty and default surcharge in accordance with sections 33 and 34: Provided that where a person required to file a tax return files the return after the due date and pays the amount of tax payable in accordance with the tax return alongwith default surcharge and penalty, the notice to show cause and the order of assessment shall abate. (2) Where a person has not paid the tax due on supplies made by him or has made short payment or has claimed input tax credit or refund which is not admissible under this Act for reasons other than those specified in sub-section (1), an officer of Inland Revenue shall make an assessment of sales tax actually payable by that person or determine the amount of tax credit or tax refund which he has unlawfully claimed and shall impose a penalty and charge default surcharge in accordance with sections 33 and 34." Section 11 in this form derived from its substitution by the Finance Act, 1996 (IX of 1996), as later amended; the words "Inland Revenue" replaced "Sales Tax" with effect from 5th June, 2010, and "default surcharge" replaced "additional tax" by the Finance Act, 2005; the substance of both sub-sections was otherwise the same throughout the periods in question.

Section 36(1), (2) and (3), as they stood during the periods in question and until the section was omitted by the Finance Act, 2012 (XVII of 2012): "(1) Where by reason of some collusion or a deliberate act any tax or charge has not been levied or made or has been short-levied or has been erroneously refunded, the person liable to pay any amount of tax or charge or the amount of refund erroneously made shall be served with a notice, within five years of the relevant date, requiring him to show cause for payment of the amount specified in the notice. (2) Where, by reason of any inadvertence, error or misconstruction, any tax or charge has not been levied or made or has been short-levied or has been erroneously refunded, the person liable to pay the amount of tax or charge

file his return, or who pays less than the tax actually payable because of a miscalculation. Section 11(2) concerned a person who “has not paid the tax due on supplies made by him”, has made short payment, or has claimed input tax credit or refund which is not admissible. Both look to the person’s own liability as it ought to appear in his own return. The one per cent in question was not tax on supplies made by the applicant; it was a part of the tax on supplies made to the applicant, which it was to deduct from what it paid its suppliers. Section 36 dealt with tax which had not been levied, or had been short-levied or erroneously refunded, and required notice to “the person liable to pay” it; sub-section (1) applied where this was “by reason of some collusion or a deliberate act”, and sub-section (2) where it was by reason of inadvertence, error or misconstruction. None of these provisions speaks of a person who was required to withhold tax from another and did not do so.

13. In *Allama Iqbal Open University*, relied on by learned counsel for the applicant, the department had proceeded against a withholding agent under the same Rules for the period July 2012 to June 2013, relying on section 11(4), the provision which after 2012 took the place of section 36(2).⁶ The Supreme Court held:

or the amount of refund erroneously made shall be served with a notice within three years of the relevant date, requiring him to show cause for payment of the amount specified in the notice: Provided that, where a tax or charge has not been levied under this sub-section, the amount of tax shall be recovered as tax fraction of the value of supply. (3) The officer of Inland Revenue empowered in this behalf shall, after considering the objections of the person served with a notice to show cause under sub-section (1) or sub-section (2), determine the amount of tax or charge payable by him and such person shall pay the amount so determined: Provided that order under this section shall be made within one hundred and twenty days of issuance of show cause notice or within such extended period as the Commissioner may, for reasons to be recorded in writing, fix, provided that such extended period shall in no case exceed sixty days ...”. Section 36 in this form derived from its substitution by the Finance Act, 1996 (IX of 1996); the earlier version had allowed ten years under sub-section (1).

The Appellate Tribunal took the same view of section 11(2) in *Shahzaib Brothers Paper Cone* [PTCL 2018 CL. 391], holding that it caters only for non-payment and short payment of the tax due on supplies made by a person and does not cover, expressly or by implication, a failure to withhold.

⁶By the Finance Act, 2012 (XVII of 2012), assented to on 26th June, 2012, section 36 was omitted and section 11 was substituted so as to consolidate the provisions for assessment and recovery. Sub-sections (3) and (4) of the substituted section 11 read: “(3) Where by reason of some collusion or a deliberate act any tax or charge has not been levied or made or has been short-levied or has been erroneously refunded, the person liable to pay any amount of tax or charge or the amount of refund erroneously made shall be served with a notice requiring him to show cause for payment of the amount specified in the notice. (4) Where, by reason of any inadvertence, error or misconstruction, any tax or charge has not been levied or made or has been short-levied or has been erroneously refunded, the person liable to pay the amount of tax or charge or the amount of refund erroneously made shall be served with a notice requiring him to show cause for payment of the amount specified in the notice: Provided that, where a tax or charge has not been levied under this sub-section, the amount of tax shall be recovered as tax fraction of the value of supply.” Section 11 was itself omitted

“There is, however, nothing in section 11(4) which deals with the responsibility of withholding of taxes. The situations and events demonstrated in the show cause notice are, in fact, covered in terms of section 11(4A) which was introduced by the Finance Act, 2016, whereas, the tax periods disclosed in the show cause notice were from July, 2012 to June, 2013. ... The recovery provisions of section 11(4A), in consequence of not deducting and/or depositing the tax, came much after the issuance of the show cause notice via Finance Act, 2016 and could not at all have been pressed in service.”

14. That reasoning answers the submission made on behalf of the department, and applies with equal force here. The periods before us, July 2009 to June 2011, are earlier still, and the provisions invoked belong to the same family as the one considered by the Supreme Court: sections 36(1) and 36(2) were the forerunners of sections 11(3) and 11(4), and sections 11(1) and 11(2) are, if anything, further from the point, being tied to the person's own return and his own supplies. The only provision which the Supreme Court found to reach the default of a withholding agent, section 11(4A),⁷ was enacted in 2016, years after these periods and after the orders-in-original were passed. The later course of the legislation is to the same effect: when section 11 was omitted by the Finance Act, 2024, the Legislature again made separate provision for the purpose, in section 11F, headed “Failure to withhold sales tax”.⁸
15. Section 36(1) meets a further difficulty. It applied only where tax had escaped “by reason of some collusion or a deliberate act”. Neither show cause notice alleged collusion or a deliberate act,

by the Finance Act, 2024 (X of 2024), assented to on 29th June, 2024, and its subject matter now lies in sections 11D to 11G.

⁷Section 11(4A), inserted by the Finance Act, 2016 (XXIX of 2016), assented to on 24th June, 2016: “(4A) Where any person, required to withhold sales tax under the provisions of this Act or the rules made thereunder, fails to withhold the tax or withholds the same but fails to deposit the same in the prescribed manner, an officer of Inland Revenue shall after a notice to such person to show cause, determine the amount in default.”

⁸Section 11F, inserted by the Finance Act, 2024 (X of 2024): “11F. Failure to withhold sales tax.— Where any person, required to withhold sales tax under sub-section (7) of section 3, fails to withhold the tax or having withheld the tax fails to deposit the same in the prescribed manner, the officer of Inland Revenue not below the rank of Assistant Commissioner shall after a notice to such person to show cause pass an order to determine and recover the amount in default and impose penalty and default surcharge under section 33 and 34.”

still less gave particulars of it, and neither order-in-original records a finding to that effect. The applicant raised this objection in its very first reply.⁹

16. The learned Tribunal examined the matter on the footing that the one per cent was sales tax envisaged by the Rules and that the withholding regimes under the two statutes differ. The anterior question, whether the Act then gave the officer any power to recover that amount from the purchaser, did not receive separate consideration, and the law on it has since been settled by the Supreme Court. Measured against that settled position, the demands of Rs.623,912 and Rs.1,175,004, and the default surcharge on them, cannot be sustained.
17. This conclusion disposes of both references, and the remaining questions need no answer. We therefore express no view on whether the suppliers' payment would by itself have answered the demand, on the premise of question (3), or on the vires of sub-rule (3B). Nor is anything said about the penalties retained by the learned Commissioner (Appeals), which the applicant accepted and which are not the subject of any question before us.

V. THE ANSWERS TO THE QUESTIONS

18. In each reference, question (7) is answered in the negative, in favour of the applicant and against the department. Questions (1) to (6) do not require an answer.

VI. ORDER

19. Both reference applications are allowed. The common order of the learned Tribunal dated 07.08.2015 in STA Nos. 126/KB/2012 and 127/KB/2012 is set aside to the extent that it restored the demands of Rs.623,912 for July 2009 to June 2010 and Rs.1,175,004 for July 2010 to June 2011, with default surcharge, on account of the failure to withhold under the Rules; to that extent the orders of the learned Commissioner Inland Revenue (Appeals-

⁹On the analogous provision of the Customs Act, 1969, a notice founded on the collusion limb must carry that allegation with proper particulars, and is defective without it: *Khyber Electric Lamps* [2001 SCMR 838].

III), Karachi dated 02.06.2012 stand restored. There shall be no order as to costs.

20. Let a copy of this judgment be sent under the seal of this Court to the learned Appellate Tribunal Inland Revenue, Karachi, as required by section 47 of the Act.

J U D G E

J U D G E

Karachi,

Dated: ____day of October 2026

Announce by:

J U D G E

J U D G E

Ayaz PS.