IN THE HIGH COURT OF SINDH, KARACHI

I.T.R.A. No. 370 *of 2017*

PRESENT:

MR. JUSTICE AQEEL AHMED ABBASI &
MR. JUSTICE ZULFIQAR AHMED KHAN.

The Commissioner Inland Revenue, Zone-I, LTU

Vs.

M/s. The Bank of Tokyo – Mitsubishi UFJ Ltd.

Applicant:	through Mr. Altamash Faisal Arab, advocate
Date of Hearing:	16.10.2018.
Date of Order:	16.10.2018.

O R D E R

Aqeel Ahmed Abbasi, J:- Through instant reference application, the applicant has proposed following question, which according to learned counsel for the applicant, is a question of law, arising from the impugned order dated 23.06.2017, passed by the Appellate Tribunal Inland Revenue [Pakistan], Karachi Special Bench, Karachi in ITA No. 692/KB of 2011 [Tax Year 2004], for opinion of this Court:-

> *"Whether on the facts and in the circumstances of the case, the learned Tribunal was justified in confirming CIR (A)'s order who deleted the addition made on account of interest charged on concessional loans advanced to executives/employees when employees' behavior to forego interest income entails foregoing income tax @ 44%, is of the nature of an associate and requires re-characterization u/s 109 of the Income Tax Ordinance, 2001?*

2. Learned counsel for the applicant, after having read out the above question proposed through instant Reference Application, and the finding of the Commissioner (Appeals) and also the decision of the Appellate Tribunal with particular reference to finding as recorded in Para: 8 of the impugned order, while confronted to point out any factual error or legal infirmity in the concurrent finding as recorded by the two appellate forums in the instant case, has candidly stated that prima facie, the order passed by the Appellate Tribunal, while confirming the order of the Commissioner (Appeals) in the

instant case does not suffer from any illegality, therefore, does not give rise to any substantial question of law, particularly, when the Appellate Tribunal has been pleased to hold that "department is at liberty to find out the returns of such employees/Directors and if the excess perquisites are not offered for tax in their relevant returns, appropriate action as per law may be taken against them".

3. We have heard the learned counsel for the applicant, perused the proposed question and the impugned order passed by the Appellate Tribunal in the instant case, and have also examined the relevant provisions of law i.e. Sections 21(k), 108/109 read with Section 85 of the Income Tax Ordinance, 2001. It will be advantageous to reproduce hereunder the relevant finding of the Appellate Tribunal as contained in Para '8' of the impugned order, which reads as follows:-

> *"8. Now we come to take up the appeal of the Department.*
>
> *To understand the issue in hand, we feel it in the fitness of things to quote the relevant findings of the learned CIR (A) in the impugned order, which reads as under:-*
>
> **Quote**
>
> *Coming to the next ground of appeal, the order also states that the Bank had not charged interest on loans of Rs.22.791 million advanced to directors, executives or officers in the year 2004 and Officer Inland Revenue has invoked the provision of 109 of the Income Tax Ordinance, 2001. This has been done without allowing opportunity of being heard showing intention for the action to be taken against the appellant. Since the bank had extended loan to the employees as per the Bank policy and added back the sum of Rs.833,800 to the income of the appellant by invoking the provision of section 21(k) of the Income Tax Ordinance 2001.*
>
> *The undersigned is deeply concerned on application of Sections 108/109, which canoe invoked as the section 85 clearly provides that two persons shall not be associates solely by the reason of the fact that one person is an employee of other. The loan given to employees is not a transaction between associates*

*if it is given according to the terms of the employment. Also on the ground that no notice was given by the Officer Inland Revenue under Section 122(9) of the Income Tax Ordinance, 2001, mentioning his intention to invoke the provisions of sections 108 & 109 therefore any action under 108 * 109 without providing the opportunity of being heard is illegal and not sustainable under the law.*

In this context the officer Inland Revenue has applied ***arms length*** *transaction principle and has worked out fair market value of such benefit. Arms length transactions are covered u/s 108 of the Income Tax Ordinance, 2001 where by the Commissioner may apply the said principle in the case of associates and allocate/distribute/apportion the income among the associates. While taking into consideration the provisions of Section 108 of the Income Tax Ordinance, 2001, the officer is obliged under the Rules in Chapter – VI of Income Tax Rules, 2002 to evolve method and ways and means as to how to apply the provision of Section 108 of Income Tax Ordinance, 2001. Rule No.23 of Income Tax Rules, 2001 provides the standard of arm's length which includes following methods for determination of Arms length transaction:*

a. *the comparable uncontrolled price method;*
b. *the re-sale price method;*
c. *the cost plus method; or*
d. *the profit split method.*

In case no result comes out by application of these methods, the Commissioner may use any other method which should he consistent with the arms length transaction. Rule – 24 prescribes the comparable uncontrol price method, Rule-25 deals with resale price method, Rule-26 applies on cost plus method and Rule-27 gives the method for profit split. In the impugned order the Officer Inland Revenue has neither confronted the appellant with the provision of section 108 of Income Tax Ordinance, 2001 in true sprit nor has referred to Chapter-VI of Income Tax Rules, 2002 whereby putting specific pointation on the applied Rule from 24 to 27 which are prescribed for determination of arms length transaction. Without referring to Section 108 read with provision in Chapter-VI of Income Tax Rules, 2002, the principle of arms length transaction as mentioned by Officer Inland Revenue on Page No.8 of the impugned order is fatal. Officer Inland Revenue was under legal obligation to follow the law and procedure of application of arm length transaction principle. Mere making reference to this principle without following its law and procedure is un-curable mistake on the part of the officer.

In view of the above discussion the fair market value of the benefit is not an income, and there is no such benefit derived by the appellant except what was declared in the return of income. Besides above the Officer Inland Revenue could not establish exact business relation between the loaner and the appellant. The Officer Inland Revenue on one hand has referred the arms length transaction in his impugned order and one the other hand he has not followed the law and procedure as prescribed in Section 108 of Income Tax Ordinance, 2001 read with Chapter – VI of the Income Tax Rules, 2002.

Now reference to Section 109 of the Income Tax Ordinance, 2001 also evolves different eventualities. It is evident from the contents of the provision of section 109 of the Income Tax Ordinance, 2001, which read as follows:

109. Recharacterisation of Income and deductions:

(1) For the purposes of determining liability to tax under this Ordinance, the commissioner may:-

- *(a) recharacterisation of transaction or an element of a transaction that was entered into as part of a tax avoidance scheme;*
- *(b) disregard a transaction that does not have substantial economic effect; or*
- *(c) recharacterise a transaction where the form of the transaction does not reflect the substance.*

(2) In this section, "tax avoidance scheme" means any transaction where one of the main purposes of a person in entering into the transaction is the avoidance or reduction of any person's liability to tax under this Ordinance.

From the bare reading of above provision of law and on going through the impugned order, it is transpired that none of the conditions laid down by the legislature has been established by the Additional Commissioner Inland Revenue, while restoring to action. The department has not been able to establish the fact that the loan advanced to employee fall in the ambit of Section 108 or Section 109 of the Income Tax Ordinance, 2001.

Even otherwise, the impugned order is silent on the aspect of charge of interest, which according to the learned AR of the appellant stood taxed at benchmark rate in the hands of Directors/employees. Therefore the addition made on this count is not sustainable and is hereby deleted."

Unquote

Here before this forum, the learned DR, from the Department could not further confront the

findings of the learned CIR (A), given in detail in the impugned order, and quoted hereinabove. Simultaneously the AR, argued that difference between the rate of interest on loan/advance paid to the employees/Directors has been charged u/s 13 and included in the calculation of excess perquisites in the income of Directors/employees. The AR filed a working in respect of Directors/employees to whom excess perquisites were charged.

The AR further argued that section 108/109 of the Ordinance regarding recharacterisation is not applicable in this situation, as discussed in detail by the CIR (A) in his order too.

The learned DR could not controvert the arguments by the AR as mentioned above. Hence, after going through the detailed order of learned CIR(A), quoted hereinabove and arguments of AR before this forum, we do not find any reason to interfere with findings of the learned CIR(A) on this issue, which is hereby upheld and the Departmental appeal fails on this ground.

Department is however, at liberty to find out the returns of such employees/directors and if the excess perquisites are not offered for tax in their relevant returns, appropriate action as per law may be taken against them.

The Departmental appeal for Tax Year 2004 is disposed off in the manner indicated above."

4. From perusal of hereinabove concurrent findings as recorded by the Commissioner (Appeals) and the Appellate Tribunal it appears that after correct appraisal of facts, and application of relevant provisions of law i.e. Sections 21(k), 85, 108 & 109 of the Income Tax Ordinance, 2001, the treatment given by the Taxation Officer to the loan advanced by the bank to its employees, has been set-aside for the reason that Taxation Officer could not establish that the transaction of advancing loan to its employees by the bank, was covered under the definition of a transaction between persons who are **associates** in terms of Section 85 read with Section 108 of the Income Tax Ordinance, 2001, therefore, its recharacterisation under Section 109 of the Income Tax Ordinance, 2001, was not justified.

5. In view of hereinabove facts and circumstances of the case, we are of the opinion that finding as recorded by Commissioner (Appeals), duly approved by the Appellate Tribunal on the subject

controversy, is based on correct appraisal of facts and application of law, therefore, does not give rise to any substantial question of law, hence, does not require any interference by this Court, under its reference jurisdiction, in terms of Section 133 of the Income Tax Ordinance, 2001. Accordingly, we do not find any substance in the instant Reference, the same is dismissed in limine alongwith listed application, and the question proposed hereinabove is answered in “AFFIRMATIVE” against the applicant and in favour of the respondent.

JUDGE

JUDGE

A.S.