IN THE HIGH COURT OF SINDH AT KARACHI

ITRA 198 of 2011

Present: **Muhammad Ali Mazhar** and **Agha Faisal**, **JJ**.

Pakistan Mercantile Exchange Limited
vs.
Commissioner Inland Revenue - Zone 1

For the Applicant:	Barrister Hussain Ali Almani
For the Respondents:	Mr. Shahid Ali, Advocate
Dates of Hearing:	14.11.2018 & 20.11.2018
Date of Announcement:	12.02.2019

JUDGMENT

Agha Faisal, **J**: The sole question framed by the Court for determination herein was recorded vide the Order dated 13.10.2014 in the following terms:

> "Whether the amount deposited by its Members with the Applicant, as security deposit can be treated as its income?"

2. The facts, demonstrated before in reliance upon the record arrayed on file and pertinent to the present controversy, are encapsulated herein below:

I. The applicant, being the Pakistan Mercantile Exchange Limited [formerly National Commodity Exchange Limited] ("**Exchange**"), has established and regulates the first commodities / futures exchange in Pakistan. In order to trade on the Exchange a broker must apply to become a member. During the Tax Year 2003

membership was governed by the Membership Rules 2002 ("**Rules 2002**") and the General Regulations of the National Commodities Exchange Limited 2003 ("**Regulations 2003**"). In 2007, these were replaced by the General Regulations of the National Commodities Exchange Limited 2007 ("**Regulations 2007**").

II. Rule 2 (Chapter 3) of the Rules 2002 empowered the board of directors of the Exchange ("**Board**") to regulate the membership of the Exchange in terms delineated herein below:

> "The Board shall have power to establish categories of membership and to attach different rights, benefits, obligations and liabilities to each category established. Such categories may, for example, include Specific Membership which would authorize the Member to trade only in one specific commodity authorized or Universal membership which would entitle the Member to trade in all commodities on the Exchange. In addition to such categorization, the Board my allow a Member to be active, which will mean that the Member will be allowed to trade on the Exchange as a broker subject to payment of Clearing House Deposit. The Board may from time to time, prescribed different fees payable for different categories of Membership and processing applications and for such other matters as the Board may in its discretion consider appropriate."

III. The Board, through a resolution dated 23.09.2002 ("**Resolution**"), stipulated that each person applying for membership had to pay an entrance fee of Rs. 250,000 and a refundable security deposit of Rs. 750,000. The Resolution provided that the security deposit is refundable to a member when he resigns, subject to receipt of a new security deposit from an incoming member. Rule 94(a) of the Rules 2002 provided that the security deposit is to be used to meet any loss or liability of a member / broker who defaults. Rule 94(b) further provided that the Exchange had a lien over the security deposit.

IV. Rules 2002 and Regulations 2003 were superseded by Regulations 2007. Regulation 12.12 of Regulations 2007 provided that security deposit is to be refunded to a person when he ceases to be a broker/member even if he does not transfer his membership. Furthermore, under Regulations 2007 the refundable security deposit becomes part of the Settlement Guarantee Fund ("**Fund**") and as per Regulation 12.6.1 this fund is used to meet any loss or liability arising out of default of a member/broker. Regulation 12.7 provided that whenever a broker defaults the Exchange may utilize any monies lying to the credit of the broker to fulfill these obligations. Regulation 12.15 of the Regulations 2007 (similar to Rule 94(b) of the Rules 2002) provided that the Exchange shall have a lien over all amounts deposited by a broker towards the security deposit.

V. The issue reportedly arose on 31.12.2003, when the Exchange filed its original return for the tax year 2003, which was revised and re-filed on 30.12.2004. On 24.12.2008, the Exchange received a notice under Section 122(5A) of the Income Tax Ordinance 2001 ("**Ordinance**") expressing the taxation officer's intention to treat the security deposits paid by its members as the Exchange's income. On 31.01.2009 the taxation officer amended the assessment order, taxing the security deposits as the Exchange's income. The operative constituent of the aforesaid order is reproduced herein below:

"All these positions establish that the receipts earned by the taxpayers are not a security deposit but in fact income. It contains all the attributes of an income as the source is definite, some sort

of regularity is there, the control over the money lies with the company the company is sole beneficiary of the profit arising from investment. The company can forfeit the money with no fault of the outgoing member so there is consistency of the source. The company has not refund the amount but it is the incoming member which in fact makes the payment for the outgoing members. Further as held by the Apex Court (1997) 76 Tax 5 (S.C.Pak) it is actual as well as constructive receipt. All this indicates that the amount shown as security deposit is in fact income in the hand of the taxpayer liable to be taxed.

The further amended order for the subject Tax Year 2003 being erroneous in so far as prejudicial to the interest of revenue is therefore, hereby further amended u/s 122(4)(5A) to charge the income earned but declared as security deposits. The computation is as under."

VI. The Exchange challenged the aforesaid order before the Commissioner Appeals and on 23.04.2009 the appellate forum upheld the order of the taxation officer in terms as follows:

"Adverting to the facts of the case, the core issue involved is taxing membership fee claimed as security deposit payable by incoming member to the appellant company. It is an admitted fact that the said amount or fee is refundable in the vent of going out of member subject to condition if the same is deposited by incoming member, if any. However, this amount is not refundable to the outgoing member unless the incoming member pays the same amount, therefore the appellant keep the said amount for an indefinite period. Obviously the appellant utilizes this amount to earn profit, which is further reinvested. Hence this activity of the appellant constitutes income from investment of so called security deposit.

In view of the facts that the security deposits claim is in fact one time membership fee but classified as membership fee and security deposit payable by every incoming member, the investment/fee deposited is not refundable as and when required by the depositor on his will rather the members have no control on its utility and depositor is not beneficiary of the said investment/fee. Therefore, it can be safely concluded that for all practical purposes the appellant is vested with rights to hold the said investment and enjoys sale discretion for its utilization. Hence it establishes that so-called security deposits are nothing but income of the appellant and not liability.

In view of the above facts and discussion, the action of the Taxation Officer in treating the deposits liability claim as income of the appellant is found legally correct, hence confirmed.

The appeal fails to succeed."

VII. The Exchange filed an appeal before Appellate Tribunal Inland Revenue, which remanded the matter back to the Commissioner Appeals vide Order dated 01.08.2009. On 17.10.2009 the Commissioner Appeals, instead of deciding the case, remanded it further to the taxation officer for de novo proceedings. The Exchange filed an appeal before Appellate Tribunal Inland Revenue against order of Commissioner Appeals, however, the same was dismissed on 13.08.2010. A separate Income Tax Reference application is pending against the aforesaid order of the Appellate Tribunal Inland Revenue.

VIII. Notwithstanding the foregoing, the taxation officer proceeded with matter and on 21.10.2010 passed an order holding that the security deposits received by the Exchange are in fact income. The relevant portion of the said order is reproduced herein below:

> "All these positions establish that the receipts earned by the taxpayers are not a security deposit but in fact income. It contains all the attributes of an income as the source is definite, some sort of regularity is there, the control over the money lies with the company; the company is the sole beneficiary of the profit arising from investment. The company can forfeit the money with no fault of the outgoing member so there is consistency of the source. The company has not to refund the amount but it is the incoming member which in fact makes the payment for the outgoing members. Further as held by the Apex Court (1997) 76 Tax 5 (S.C. Pak) it is actual as well as constructive receipt. All this indicates that the mount shown as security deposit is in fact income in the hand of the taxpayer liable to be taxed."

IX. The Exchange challenged the order before the Commissioner Appeals who upheld the same on 18.05.2011. It is relevant to reproduce the essential constituent of the cited order:

"Now it raises the question what about the amount shown as a long term liability by the appellant in the audited accounts. I am deeply concerned that by declaring a revenue receipt in the balance sheet as a liability does not change its character. As held earlier that the appellant shall be maintaining these deposits and even in the event of quitting of a member, is not liable to make any refund but it is the incoming member which deposits the same amount. In this context to claim this amount as a liability by the appellant, it cannot be presumed that the same are subject to certain conditions. If so, the receipts shown as a liability is nothing except misclassification of receipt.

The above view is further strengthened from the fact that the amount could be forfeited when there is no incoming member to take the place of the outgoing member. It is observed that no security deposits could be forfeited by the receiver. In the instant case the appellant is blowing hot and cold in the same breath. On the one hand the appellant is claiming the mount as security deposit but on the other hand it has been expressly declared with so much right to forfeit the amount with no fault on part of the depositor. This, beyond any shadow of doubt, establishes the fact that as soon as the deposits are received by the appellant from incoming member it becomes owner of the said deposit and thus the same constitute income of the appellant.

Further it is a definite source in the shape of membership fee and has direct nexus between the receipt and source, which once received is never payable by the appellant.

In view of the above discussion, I feel no hesitation to hold that the receipts earned by the appellant are not a security deposit but the same is income and the amount shown as security deposit is in fact income of the appellant and liable to be taxed."

X. The Exchange filed appeal before the Appellate Tribunal Inland Revenue, wherein the earlier order was upheld on 04.06.2011 in the following terms:

> "We have heard the learned counsel for both the parties and have gone through the relevant orders. As already mentioned earlier that the sole issue involved in the present case is determination of nature of security deposit made by the incoming members of the Exchange. There is no denying the fat that these are only refundable as and when incoming members deposit the same amount this leads to the irresistible conclusion that once an amount stands deposited with the appellant, the same remains intact till such time that until/unless outgoing/defaulting members brings in a new member to replace him, then he could ask for refund for his own deposit It is pertinent to note that the incoming member deposits the same amount with the appellant. During the arguments it was conceded by the

learned A.R. that amount deposited stands forfeited if there is no incoming members, meaning thereby that the depositor/member has no control over the money deposited but it is the company which has exclusive control over the depositor's money. Therefore, whatever is deposited to the appellant as security deposit, it is the income of the appellant and same is not refundable, and this practice goes on and on. Impliedly, the incoming member has to pay the outgoing member and not to the appellant. As regards showing he said amount/security deposit as a long term liability in the accounts, we have no hesitation in making observation that the balance sheet does not change its character. It is admitted position that the appellant is not under any obligation to refund the deposited amount to a quitting member but the same is to be paid by the incoming member, hence, in the circumstances, the claim of the appellant that the said amount is a liability, is a fallacy, rather tantamount to hoodwinking the department by miss-describing the said amount. With regard to the arguments of the learned A.R. that the security deposit is used to compensate the parties in case of default member of NECL, Perusal of both the orders show that no evidence of such use has been produced before the Taxation Officer. Even otherwise, despite repeated reminders by the department the appellant did not cooperate with the authorities to ascertain real acts with regard to this aspect of the case. The learned A.R. has not been able to persuade us to warrant our indulgence which is hereby upheld.

As a result of above discussion, appeal of the taxpayer is dismissed being devoid of any force."

XI. Being aggrieved by the impugned pronouncement of the learned Appellate Tribunal Inland Revenue, the applicant preferred the present proceedings.

3. Barrister Almani laid out the case for the applicant and argued that security deposit could not be treated as income. It was argued that the Order passed by the Appellate Tribunal Inland Revenue was dissonant with the law as it unreasonably concluded that the security deposit was income of the Exchange and liable to be taxed. It was argued that the said order is bad in law since it ignored evidence showing that the Exchange refunds the security deposit to persons who cease to be members; it failed to appreciate that since no member has defaulted as

yet it is impossible for the Exchange to produce evidence of using a security deposit to settle the obligations of a member in case of default and reference can only be made to the Regulations 2007; it ignored the Regulations 2007 which clearly set out that the security deposit is to be used to fulfill the obligations of a broker who defaults and provide that the Exchange only has a lien over the security deposits; it failed to consider that on occasion when person's membership was cancelled due to contravention of the rules and his security deposit forfeited in such case, the Exchange has accepted and declared the same as income and paid tax thereon. It was submitted that an amount which is not income and has none of the characteristics of income cannot be treated as income even by operation of law since the Constitution limits the taxing power of the Federal Government to the ordinary definition of income. In this regard the learned counsel drew attention to Article 142 of the Constitution read with Entry 47 of the Federal Legislative List. Learned counsel for the applicant cited the authorities of *Habib Bank Limited vs. Liquidator National Construction Co.* reported as *2017 CLC 17* ("***Habib Bank***"), *Umar vs. S.A. Rana* reported as *PLD 1957 Karachi 760 ("**Umar**"),* *CIT vs. Madurai Soft Drinks Ltd.* reported as *2005 276 ITR 607* ("***Madurai 2***")**,** *S.Sahakari Sakhar Karkhana Ltd vs. CIT* reported as 2004 270 ITR 1 ("***S. Sahakari***"), *CIT vs. Madurai Soft Drinks Ltd.* reported as 2000 241 ITR 229 *("**Madurai 1**",) CIT vs. Trichur Kuri Syndicate* reported as 1995 211 ITR 365 *("**Trichur Kuri**"),* *CIT vs. Goyal Gases Ltd* reported as *1991 188 ITR 216 ("**Goyal Gases**") CIT vs. Bijli Cotton* reported as *1979 116 ITR 60 ("**Bijli Cotton**") CIT vs. Sanderson & Morgans* reported as *1970 75 ITR 433***,** *("**Sanderson**"),* *Upper India Sugar Exchange Ltd. vs. CIT* reported as *1969 72 ITR 331 ("**Upper India**") Agra Bullion Exchange Ltd vs. CIT*- reported as 1961 41 ITR 472 *("**Agra Bullion**"). Lakhsmanier & Sons vs. CIT* reported as

*1953 23 ITR 202 ("**Lakhsmanier**"),* *Samina Shaukat vs. CIT* reported as *PLD 1981 SC 85 at 91A ("**Samina**"),* *Pakistan Industrial Development Bank vs. Pakistan* reported as *1992 PTD 576 ("**PIDB**"),* *Elahi Cotton Mills vs. FOP reported as PLD 1997 SC 582 ("**Elahi Cotton**"),* *Punjab Small Industries v CIT reported as 2001 PTD 2282 ("**Punjab Small**")* and contended that placing reliance thereupon the question of law before the Court may be answered in the negative and in favour of the Exchange, hence, denoting that refundable members' security deposit cannot be treated as its income.

4. Mr. Shahid Ali, Advocate for Tax Department, controverted the arguments advanced on behalf of the applicant and submitted that there was no merit to the present reference application and the same may be dismissed forthwith. It was submitted that the security deposits lying with the applicant are an integral constituent of its membership pricing structure and that it was a settled law that mere accounting treatment does not affect the taxable character of a receipt. It was further contended that the so called liability is subject to forfeiture if the outgoing member does not bring in a new member with the same deposit or even resigns. In ordinary course, the enjoyment of cash flow for the applicant remains the same. In was submitted that security deposits when they are in the nature of trading receipts and are meant to ensure adjustment of mutual obligations fall within the ambit of taxable income. Learned counsel for the applicant cited the authorities of *Badri Narayan Balakishan vs. Commissioner of Income Tax* reported as *1965 57 ITR 752 AP* ("***Badri Narayan***"), *K.M.S Lakshmanier and Sons vs. Commissioner of Income Tax* reported as *AIR 1953 SC 145* ("***Lakhmanier***") and *Punjab Distilling Industries Limited vs. the Commissioner of Income Tax* reported as *1959 AIR 346* ("***Punjab***

Distilling") in order to bulwark his submission that the impugned order passed by the learned Appellate Tribunal Inland Revenue was in due consonance with the law and merited no interference in the present proceedings.

5. We have considered the arguments ably advanced by the respective learned counsel and have also appreciated the case law placed before us. The controversy for us to address has been distilled to constitute the question framed herein, as reflected by the Order dated 13.10.2014, being whether the amount deposited by the members with the Exchange, as security deposit, could be treated as its income.

6. Prior to deliberating upon the submissions of the learned counsel it may be pertinent to record that during the course of the final hearing a query was raised by us with regard to the treatment under the Ordinance with respect to amounts deposited as security in respect of tenancy relationships of immovable property and whether the said situation would be analogous with the present controversy. Barrister Almani submitted that an analogy could be drawn with respect to a security deposit received by a landlord from his tenant, which is refundable at the end of the tenancy if not utilized for repairing any damage to the property by the tenant or is otherwise forfeited under the tenancy agreement. It was demonstrated that Section 15(2) of the Ordinance, which relates to income from property, specifically provides that "rent", which is taxable under Section 15(1), includes "any forfeited deposit". So it was deduced that a deposit, unless it is forfeited, cannot be taxed as income. Per learned counsel the same principle applied to the security deposited with the Exchange by its members. It was thus argued that since the security deposit is refundable, it is clear that the

said amount does not belong to the Exchange and cannot be considered its income. Mr. Shahid Ali Advocate had accepted that the two scenarios were analogous, during the course of the hearing, and expressly stated that the in tenancy situations the security deposit is not ordinarily treated as income by virtue of it being refundable, however, the said stance was reconsidered in the written arguments that were submitted subsequently. It was stated in the written arguments that provisions of Section 16 of the Ordinance, even with a different context, still fortified the respondent's stance that security deposits can be taxed if they are in the nature of revenue receipts and mere fact that they are shown as long term liability did not extinguish their taxable character and in such regard reliance was squarely placed upon section 16(1) of the Ordinance.

7. Barrister Almani had cited case law to illuminate three propositions of law; a lien is a right in a person to retain which is in his possession but belongs to another till certain conditions are satisfied; that income ordinarily connotes a periodical monetary return with relative actual or expected regularity; and that a security deposit cannot be considered as income.

8. A Division bench judgment of this Court in *Habib Bank* and an earlier Single Bench judgment of this Court in the case of *Umar* had been relied upon to demarcate the concept of lien. *Umar*, authored by Wahiduddin Ahmed, J (as he was then), defined a lien as a right in one man to retain that which is in his possession, but belongs to another, till certain demands of the person in possession are satisfied. The subsequent Division Bench judgment in the case of *Habib Bank* reiterated the definition enunciated earlier and maintained the verbiage

enunciated earlier. The learned counsel for the respondent did not make any submissions to controvert or distinguish the argument advanced or authority cited in respect hereof.

9. The argument that income connoted a regular periodical return was bolstered by the authority of *Samina*, *PIDB*, *Elahi Cotton* and *Punjab Small*. *Samina* is a decision of the honorable Supreme Court wherein it is observed that the term 'income' generally and ordinarily it connotes a periodical monetary return, coming in with some sort of regularity, or expected regularity, from a definite source. PIDB is another pronouncement of the honorable Supreme Court wherein it is maintained that prior to charging tax an assesse must be shown to have received income or it has arisen and accrued or deemed to be so under a statute. Any amount which is not an income cannot be subjected to tax. The august bench relied upon Corpus Juris Secundum, Volume 89, at page 731, wherein it was observed that income for any given period of time is the amount of gain so derived during the designated period. That which is not income cannot be made taxable by calling it income. *Elahi Cotton* and *Punjab* Small were also employed to reiterate the ratio gleaned as above. Once again the learned counsel for the respondent did not make dispel or distinguish the argument advanced or authority cited in respect hereof.

10. The crux of the argument, advanced on behalf of the respondent relevant hereto and as featured in the judgments of the fori under consideration herein, was that since the security deposit of a member of the Exchange was non-refundable till such time as the same was not replaced by an incoming member, therefore, the said amount was income and could not be treated in any other manner. It is in this context

that it was implied that the security deposit was not a lien and further that it was not amenable to the definition of income being propagated by the applicant, even though such a definition was not exhaustive even by account of the authority cited in such regard.

11. It is an admitted fact that vide the Resolution the Board had designated that security deposit is refundable to a member upon resignation subject to receipt of a replacement security deposit from the incoming / replacing member. However, it is also clear that the said Resolution stood superseded by the prescriptions of the Regulations 2007 wherein it was provided that the security deposit is to be refunded to a person when he ceases to be a member even if he does not transfer his membership; the refundable security deposit becomes part of the Fund and this Fund is used to meet any loss or liability arising out of default of a member/broker; that whenever a broker defaults the Exchange may utilize any monies lying to the credit of the broker to fulfill these obligations; the Exchange shall have a lien over all amounts deposited by a broker towards the security deposit. Therefore, it becomes apparent that the entire premise of the respondent, justifying the treatment of the security deposit as income, fails post Regulations 2007.

12. We now consider the proposition that money taken under an obligation to repay cannot be treated as income, hence, security deposit may not be considered income. A plethora of authority has been cited before us to illustrate and controvert this proposition. The Supreme Court of India concluded in *S. Sahakari*, in the context of cooperative societies, that the non-refundable and refundable deposits cannot be treated as the income of the assesse. In the case of *Madurai 2*,

pertaining to security deposits collected from retailers and agents of soft drinks, it was opined by the Supreme Court of India that the “empty bottles return security deposits” received from the agents and retailers are not trade receipts and thus are not taxable in the hands of the assesse. The respective judgments in *Madurai 1* (referred to in *Madurai 2*), *Trichur Kuri, Goyal Gases* (referred to in *Madurai 2*), *Bijli Cotton*, *Sanderson*, *Upper India* and *Agra Bullion* were cited before us to lend further credence to the argument that security deposit cannot be connoted as income. Learned counsel for the respondent sought to distinguish the cited authority upon facts and stressed that the ratio enunciated was not applicable herein. Mr. Shahid Ali Advocate placed reliance upon the pronouncement of the Andhra Pradesh High Court and Supreme Court of India respectively in *Badri Narayan*, *Lakhmanier* and *Punjab Distilling* to lend credence to the respondent’ position.

13. It was observed in *Badri Narayan* that the liability to return money did not necessarily alter the nature of a trade receipt. *Lakhmanier* observed that the nature of security deposit under consideration were more akin to trade receipts. In order to appreciate the argument sought to be articulated vide reliance upon the aforesaid authority it is imperative to consider the nature of the security deposit held by the Exchange. It has consistently been argued by the learned counsel, and observed by the decisions of the fori under consideration herein, that the non-refundability of the security deposit except in cases where it was replaced placed the said monies in the category of income. However, the Regulations 2007 categorically dispel this notion and no reservation has been advanced by the learned counsel for the respondent to suggest that the post 2007 treatment of security deposit suffered from the same, or any, infirmity. It is thus observed that by the respondent’

own arguments the security deposits could not be deemed to be akin to trade receipts post coming into effect of the Regulations 2007. The reliance upon *Lakhmanier* is even otherwise unmerited as an arrangement whereby an agent placed a deposit with the assesse returnable upon termination of agency was determined to be a security deposit not liable to tax. In this scenario it is observed that the authority of *Badri Narayan* and *Lakhmanier* does not augment the submissions of the respondent.

14. The 1958 judgment of the Indian Supreme Court in the case of *Punjab Distilling* was cited before us, by the learned counsel for the respondent, wherein it was observed that substance was preferred over form. The context was once again the security deposit in respect of soft drink bottles and the learned counsel for the respondent drew our attention to the conclusion drawn therein that the empty bottles return security deposit was determined to be income and therefore assessable to tax. Respectfully, the learned counsel appeared unaware of the fact that a subsequent judgment of the Supreme Court of India, in *United Breweries Limited vs. State of A.P.* reported as *(1977) 3 Supreme Court Cases 530*, confined the pronouncement of *Punjab Distilling* to the special facts peculiar to the said case and observed that the judgment could not be treated as authority. It is also noted that *Punjab Distilling* was discussed at length by the Supreme Court of India in *Madurai 2* prior to concluding that the relevant security deposits are not trade receipts and thus are not taxable in the hands of the assesse.

15. Having distinguished the authority cited before us by the learned counsel for the respondent we revert to the facts and circumstances of the present case. It is clear that the Regulations 2007 treat the security

deposit as monies whereupon the Exchange maintains a lien and in the event that such a lien crystallized and the amount so maintained was forfeited then the applicant declared the same as income and the same was subject to tax. The applicant has placed before us its annual returns for the financial year 2007 to demonstrate that the security deposit of two brokers was forfeited and consequently the forfeited amount was disclosed as “other income” and thus made subject to taxation. This is analogous to the concept enunciated in section 15 of the Ordinance making security deposit assessable as income in case of its forfeiture. The respondent’s argument, not advanced during the course of the hearings but in the written synopsis submitted thereafter, that pursuant to section 16 of the Ordinance since amounts received from tenants, not adjustable as rent, are also be assessable for purposes of tax, hence, un-forfeited security deposit must be treated likewise does not find merit with us as the said interpretation would render the prescription of section 15 of the Ordinance as redundant. Section 15(2) of the Ordinance expressly deals with the treatment of forfeited deposit while Section 16(1) of the ordinance inter alia deals with the treatment of *pugree*, per commentary contained at page 294-A of Volume I of Law & Practice of Income Tax by Huzaima & Ikram, hence, the same is taxed over a period of ten years and not within the same year as would be the case if it were rent received in the said year. In addition thereto Section 15(3) of the Ordinance provides for the treatment of amounts received other than rent, inter alia for the provision of services and amenities etc. It is clear from the verbiage of the Ordinance that only forfeited deposit falls within the definition of rent, hence, taxable as such. The implication that in the event that the said deposit remains un-forfeited the same could not be treated as income is also within our contemplation.

16. While we are cognizant that the exercise of our jurisdiction herein is merited for the determination of the question of law framed, however, it is also to be considered as to what effect such determination is to have in the present facts and circumstances. The case before us pertains to the treatment of security deposit as income in respect of the tax year 2003, whereas, the Regulations 2007 came into effect much thereafter. It is well settled law that assessment relating to each year is an absolutely independent proceeding and that the facts and circumstances of a particular year could not be equated or made applicable to the facts and circumstances of another assessment year. Reliance in placed in such regard upon the Division Bench judgment of this Court in the case of *Mehran Girls College vs. Commissioner Income Tax* reported as *2001 PTD 987*, which in turn relied upon the pronouncement of the honorable Supreme Court in the case of *Commissioner Income Tax Appeals vs. Pakistan International Engineering Agencies Limited* reported as *PLD 1992 SC 562*. While assailing the impugned decision of the learned Appellate Tribunal Inland Revenue pertaining to the assessment of the tax year 2003, the learned counsel primarily relied upon the effect of Regulations 2007, which were admittedly not in force when the initial return was filed for the tax year 2003.

17. The impugned decision of the learned Appellate Tribunal Inland Revenue expressly states that "*the sole issue involved in the present case is the determination of the nature of security deposit made by the incoming members of the Exchange*". It was concluded that since no refund of the deposited amount takes place and the refund is predicated upon replacement by the incoming member, hence, terming the deposit as a liability was unmerited. The impugned decision disregards the

argument that the security deposit is used to compensate parties in the event of a default by observing that no evidence of the same having transpired was ever placed before the relevant authority. Learned counsel for the applicant had submitted that the security substitution mechanism put in place vide the Resolution was already countermanded vide the Regulations 2007 and no evidence of the utilization of the security deposit for default amelioration could have been placed before the relevant taxation officer / authority at the relevant time since no default had taken place up until the relevant time.

18. It is observed that the Resolution and the Regulations 2007 were / are the internal systems of the applicant and a subsequent change, as took place in 2007 vide the Regulations 2007, could not impact a decision arrived at in respect of the assessment of a tax year previous to the Regulations 2007 having come into effect. However, we are not convinced that since no evidence of default amelioration was adduced before the relevant authority, on account of none having taken place thus far, the entire existence of such a fund could be denigrated. The existence of the fund was apparent to the relevant authority and it was its treatment, liability vis a vis income, that was moot. In the presence of an apparent accumulating fund, purpose whereof was clearly demarcated, the purpose thereof could not be ignored simply on the ground that up till such time it had not been expended for such purpose, especially when it was clear that the opportunity for such a fund to be utilized had not been occasioned yet.

19. This leads this deliberation to its final stage, which is the determination that all other things being constant, could the security deposit maintained with the Exchange be treated as deposit, and not

income, while disregarding the provisions of the Regulations 2007, as they had not been put into place at the relevant time.

20. The Rules 2002 were reportedly notified on 30.10.2002 and Rule 2 thereof empowered the Board to prescribe the terms of membership from time to time. Rule 94(a) prescribed that in the event of a default the defaults management committee of the Exchange would call the security and other assets of the defaulter and realize the same for the benefit of the aggrieved parties. Hence, it is apparent that the security deposit was treated as an asset of the member, per Rules 2002. Rule 94(b) of the Rules contains an express stipulation recognizing the paramount lien of the default management committee upon under charge assets of the member, including the security deposit. Therefore, the existence of a fund, being the settlement guarantee fund, comprising of the aggregated security deposit is expressly recognized in the Rules 2002 and it is also designated that while the asset remains that of the member, the Exchange (or the relevant committee thereof) has a lien thereupon. The definition of lien, as enunciated vide *Habib Bank* and *Umar*, being a right in one man to retain that which is in his possession, but belongs to another, till certain demands of the person in possession are satisfied, appears to apply squarely to the security deposit maintained by the members with the Exchange, even prior to the Regulations 2007.

21. It is imperative that we reconsider the proposition, in the pre Regulations 2007 scenario, that money taken under an obligation to repay cannot be treated as income, hence, security deposit may not be considered income. The Resolution, wherein the quantum of the security deposit was prescribed, annotated the said respective amounts under the express heading *Deposit (*Refundable)*. It is thus clear that the

deposit was levied and deemed refundable, under express authority of Rule 2 of the Rules 2002, in contrast to certain other levies prescribed in the said Resolution which were expressly annotated as *non-refundable*. The controversy arose because despite the security deposit having been designated as refundable the asterisk appended to the term refundable denoted that "*Refundable when resigning from membership and subject to receipt of the same deposit from in-coming member*". It is this footnote that gave rise to the present predicament pending adjudication since 2004.

22. While the terms governing the refund of the security deposit post the Regulations 2007 are clearer and preferable to the pre 2007 scenario, it cannot be said that the earlier prescription did not connote the relevant amounts as refundable security deposits. The deposits were made pursuant to the Rules 2002 in order to seed the fund created for default amelioration. While the refundability of the amount was not in dispute the fact that it was refunded upon replacement does not take away from the nature of the deposit. At the onset it is noticed that refund could only take place to the depositor of the fund and that remained the case pre 2007 as well. The fact that this was made conditional upon replacement by a subsequent member did not take away from the fact that refund was in fact always contemplated. The replacement criterion, although less than ideal, would protect the quantum of the settlement guarantee fund and resultantly cause no diminution to the protection available to the general public in case of a default, as the fund would not be diminished even in the intervening period that one member ceases to exist and another takes its place.

23. It was observed in the case of *S. Sahakari* that even non-refundable deposits were held to fall outside the ambit of income. Notwithstanding the said pronouncement, even if the pre 2007 scenario is subjected to the anvil of the pronouncements, enumerated supra and reiteration whereof is eschewed on account of brevity, denoting that deposits could not be treated as the income of an assesse, it would transpire that the amounts deposited by the members of the Exchange therewith as security could not be treated as the income of the Exchange.

24. In view of the reasoning and rationale contained herein the question framed for determination by this Court, vide order dated 13.10.2014, is answered in the negative, hence, in favour of the applicant and against the respondent. This reference application stands disposed of in the above terms. A copy of this decision may be sent under the seal of this Court and the signature of the Registrar to the learned Appellate Tribunal Inland Revenue, as required by section 133(5) of the Ordinance.

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