IN THE HIGH COURT OF SINDH AT KARACHI

CP D 6071 of 2019	:	Sawera Industries Cotton Ginning Pressing Factory and Oil Mills vs. Federation of Pakistan & Others
CP D 3073 of 2019	:	Insaf Cotton Ginning & Pressing Factory and Oil Mills vs. Pakistan & Others
CP D 3074 of 2019	:	Mehran Cotton Ginning Pressing Factory and Oil Mills vs. Pakistan & Others
CP D 3075 of 2019	:	Soneri Cotton Ginning Pressing Factory and Oil Mills vs. Pakistan & Others
CP D 3076 of 2019	:	Super Star Ginning & Pressing Factory and Oil Mills vs. Pakistan & Others
CP D 6349 of 2019	:	Marvi Cotton Ginners vs. Federation of Pakistan & Others
CP D 6072 of 2019	:	Jubilee Cotton Ginning Pressing Factory and Oil Mills vs. Federation of Pakistan & Others
CP D 6073 of 2019	:	Jethani Cotton Industries and Oil Mills vs. Federation of Pakistan & Others
CP D 6074 of 2019	:	Dewan Cotton Ginning Pressing Factory and Oil Mills vs. Federation of Pakistan & Others
CP D 6520 of 2019	:	Sonia Cotton Ginning Pressing Factory & Oil Mills vs. & Others
CP D 6521 of 2019	:	Al-Karam Cotton Ginning Pressing Factory & Oil Mills vs. Federation of Pakistan & Others
CP D 6522 of 2019	:	S.S. Cotton Ginning Pressing Factory & Oil Mills vs. Pakistan & Others
CP D 6539 of 2019	:	Geo Shahenshah Cotton Ginners & Oil Mills vs. Pakistan & Others
CP D 6741 of 2019	:	New Indus Cotton Ginning Pressing Factory & Oil Mills vs. Federation of Pakistan & Others
CP D 6742 of 2019	:	Sada Bahar Kohistan Cotton Ginning Pressing Factory & Oil Mills vs. Federation of Pakistan & Others
CP D 197 of 2020	:	Abadgar Cotton Ginning Pressing Factory & Oil Mills vs. Federation of Pakistan & Others

For the Petitioners	:	Mr. Muhammad Faheem Bhayo Advocate Mr. Muhammad Din Qazi Advocate
For the Respondents	:	Mr. Kafil Ahmed Abbasi Deputy Attorney General Mr. Shakeel Ahmed, Advocate
Date of hearing	:	23.11.2020
Date of announcement	:	23.11.2020

JUDGMENT

Agha Faisal, **J**. The present petitions have assailed SRO 253(I)/2019 dated 26.02.2019 ("Impugned SRO"); seeking to recover sales tax on the supply of cotton seed, notwithstanding Entry 81 of the Sixth Schedule ("Sixth Schedule") to the Sales Tax Act 1990 ("Act"), wherein the same enjoys statutory exemption. Since the subject matter was common *inter se*, therefore, these petitions were heard conjunctively and shall be determined vide this common judgment.

2. Per petitioners' counsel statutory exemption could not be whittled away by resort to a notification; the retrospective aspect[1] of the Impugned SRO was outside the permissible confines of the law; and the denial of input tax adjustment was without foundation. It was concluded that all these aspects had been duly considered by an earlier Division Bench of this court in *Insaf Cotton*[2]; and that the ratio thereof remains binding[3] upon this bench.

3. Learned counsel[4] for the respondents submitted that they had no cavil to the binding nature of Division Bench judgments; however, it was argued[5] that *Insaf Cotton* had been set aside. The premise advanced was that the said judgment was relied upon by a judgment[6] of the honorable Lahore High Court; the ambit whereof was confined to the implication of *Mustafa Impex*[7] by the honorable Supreme Court[8].

4. We have heard the arguments of the respective learned counsel and have also considered the authority to which our surveillance was solicited. In order to efficaciously adjudicate this *lis* it is considered appropriate to frame the following questions for determination:

a. Whether the matter is covered by *Insaf Cotton.*

b. Whether *Insaf Cotton* has been set aside.

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1 Impugned SRO is dated 26.02.2019; however, seeks to recover with effect from 01.07.2018.

2 Per *Munib Akhtar J* in *Insaf Cotton Ginning and Pressing Factory and Oil Mills vs. Federation of Pakistan & Others* reported as *2016 PTD 2585* ("*Insaf Cotton*").

3 Per *Sajjad Ali Shah CJ.* in *Multiline Associates vs. Ardeshir Cowasjee & Others* reported as *1995 SCMR 362*.

4 Mr. Kafil Ahmed Abbasi, Deputy Attorney General.

5 Mr. Shakeel Ahmed, Advocate.

6 *Dawn Ginning Industries & Oil Mills vs. Federation of Pakistan & Others* [*W.P. 5571 of 2015 Multan*] ("*Dawn Ginning 1*").

7 *Mustafa Impex & Others vs. Pakistan & Others* reported as *PLD 2016 Supreme Court 808 ("Mustafa Impex")*.

8 *FBR vs. Dawn Ginning Industries & Oil Mills and connected matters* [*CP 1028 of 2017* and connected matters] ("*Dawn Ginning 2*").

Whether the matter is covered by *Insaf Cotton.*

5. A similar controversy[9] was agitated before an earlier Division Bench of this Court wherein SRO 188 was assailed on the very grounds invoked before us. It is considered illustrative to reproduce the pertinent discussion and the findings from *Insaf Cotton* herein below:

> "8.[10] The position as relevant for present purposes can be stated as follows. The petitioners process raw cotton in their cotton ginning units and, inter alia, obtain cottonseed. This is used by oil expelling/extracting units to, inter alia, produce cottonseed oil and oil cake. Some of the petitioners have composite units and use some or all of the cottonseed in-house in oil expelling/extracting operations to produce cottonseed oil and oil cake themselves. Thus, as presently relevant, there are three supplies that can be made the subject of sales tax. Firstly, and most importantly, there is the supply of cottonseed. Secondly, there is the supply of cottonseed oil, and thirdly there is the supply of oil cake. Rule 58X makes clear that Chapter XV intends to tax the supply of cottonseed to be used for oil extracting purposes, and expressly states that it applies to both those cotton ginning units as supply cottonseed to others as well as those that have composite operations. Rule 58Y(1) amplifies on this by providing both the rate of tax (Rs. 6 per 40 kg), and when the sales tax is payable. In the case of supply to third party oil extracting/expelling units, this is at the time of the said supply. In the case of in-house use by composite units, it is at the time of such use. Now, it is not denied by the respondents that the supply of cottonseed is, and has been at all material times, wholly exempt in terms of entry No. 81 of the Sixth Schedule to the 1990 Act. This Schedule is to be read with section 13(1), which states as follows:
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> > **"13. Exemption.** (1) Notwithstanding the provisions of section 3, supply of goods or import of goods specified in the Sixth Schedule shall, subject to such conditions as may be specified by the Federal Government, be exempt from tax under this Act."
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> It is pertinent to note that certain provisos were added to subsection (1) in 1999 but omitted in 2000. These were as follows:
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> > "Provided that the Federal Government may, by notification in the official Gazette, withdraw any exemption granted under the Sixth Schedule to the extent specified in the notification:
> >
> > Provided further that the aforesaid power to withdraw an exemption shall not be construed to include the power to revive or to restore the exemption so withdrawn."
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> As the provisos make clear, but is in any case plain on a bare reading of section 13(1), the words "subject to such conditions as may be specified by the Federal Government" cannot be so construed and applied as to withdraw or nullify the exemption itself as contained in any entry of the Sixth Schedule. It is to be noted that the Sixth Schedule can only be amended by the legislature. Some of the entries grant exemption subject to the limitations as therein specified. Other entries however, grant the exemption without any limitation being attached. This is the position with regard to cottonseed: entry No. 81 imposes no limitation on the exemption. In our view, the proper interpretation and application of section 13(1), as read with the Sixth Schedule, is that the entries thereof determine the scope and extent of the exemption. This is set by the legislature itself and can be neither expanded nor narrowed by the Federal Government. The grant of the exemption is entirely the domain of the legislature. All that the Federal Government can do in terms of section 13(1) is to regulate the manner in which the exemption granted is to be availed. It is only to this extent and for this purpose that conditions can be imposed by it. Thus, the power of the Federal Government in terms of section 13(1) is strictly limited. In particular, it cannot trespass on the area that the legislature has reserved for itself alone. In the present context, it is also pertinent to note that subsection (1) is not even mentioned in the opening paragraph of SRO 188: it only refers to section 13(2)(a). What Rule 58X and Rule 58Y(1) however purport to do, by imposing sales tax on the supply of cottonseed, is to, in effect, nullify and withdraw the exemption granted by entry No. 81. This, the Federal Government is patently not empowered to do. The grant of an exemption by a statutory provision in the parent Act, which can only be altered by the legislature itself, cannot be denied or defeated in the exercise of any subordinate rule making power. In our view therefore, the purported levy of sales tax on cottonseed is clearly contrary to entry No. 81 and thus ultra vires the provisions of the 1990 Act.
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> 9. As is obvious, the foregoing conclusion sounds, as it were, the death knell for Chapter XV since SRO 188 is premised on the supply of cottonseed being subject to sales tax. If that levy is unlawful, as it has to be for the reasons just stated, the entire structure of the notification, and certainly the object sought to be achieved by it, fails. It is also to be noted that the rate of the sales tax is immaterial: any sales tax imposed on the supply of cottonseed would fall foul of entry No. 81 of the Sixth Schedule and fail immediately. Furthermore, this conclusion applies equally to the supply of cottonseed to third party oil extractors/expellers as well as the in-house use of the cottonseed by composite units. The reason is that, in law, there would have to be a "supply" by the composite unit to itself of the cottonseed for the mechanism envisaged by Chapter XV to work. Here, there may be an additional complication. Section 2(33) defines "supply" as meaning, inter alia, "a sale or other transfer of the right to dispose of goods as owner". This appears to imply that for purposes of the 1990 Act, there must be a sale or disposal to another person for there to be a "supply". In other words, self-use or consumption would appear to fall outside the ambit of "supply". However, we express no definite finding on this (otherwise important) point, since it is not necessary for us to do so for present purposes. It suffices to note that even in the case of composite units, the self-use must necessarily constitute a "supply" of the cottonseed within the meaning of the 1990 Act. But any such "supply" would also necessarily be exempt by reason of entry No. 81 of the Sixth Schedule.

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[9] Albeit with respect to an earlier notification, being SRO188(I)/2015 dated 05.03.2015 ("SRO 188").

[10] Statutory exemption aspect.

10. We may note that we expressly invited submissions by learned counsel for the Department and the learned departmental representative on the foregoing points, and specifically asked them to point out any provision in the 1990 Act as would allow or enable the Federal Government to, as it were, override an exemption granted in the parent Act in the exercise of rulemaking powers. No such provision was shown to us. Reliance was placed on section 3(6), but that provision cannot take precedence over section 13(1), which opens with a non-obstante clause that overrides section 3 in its entirety. Therefore in our view, Rules 58X and 58Y(1) are ultra vires entry No. 81 of the Sixth Schedule to the 1990 Act.

11.[11] The other objection taken by learned counsel for the petitioners is that SRO 188 has been given impermissible retrospective effect: the notification was issued on 05.03.2015 but given effect from 01.07.2014. This is for the reason that it imposes a fiscal burden on the supply of cottonseed (by purporting to negate the exemption granted by the parent Act) and it is well settled that no notification that does so can have retrospective effect. In our view, this objection is well founded. Learned counsel for the Department and the learned departmental representative sought to argue that the notification was beneficial and hence could have retrospective effect. However, it is clear that any supposed benefit of the notification is to the account of the oil extracting/expelling units and not the cotton ginning units. What Rule 58Y(5) exempts is the supply of oil cake produced from cottonseed to which Chapter XV applies. SRO 188 is certainly not beneficial to cotton ginning units since it denies to them the benefit of the exemption granted by entry No. 81. While composite units may have the benefit of Rule 58Y(5), many of the petitioners before us do not operate such units. They are admittedly only involved in cotton ginning. Therefore, insofar as those petitioners are concerned (who would appear to constitute a significant portion of the total number if not the majority), the notification could not possibly be given retrospective effect, on the basis of well established principles.

12.[12] Another objection taken by learned counsel for the petitioners is that Rule 58Y(3) denies the benefit of input tax adjustment in respect of cottonseed supplied in terms of Chapter XV. This, it is contended, is ultra vires the 1990 Act as it is contrary to the basic mechanism of output minus input tax adjustment that is fundamental to the VAT mode. This objection also appears to be well taken. The importance and central role of the output minus input tax mechanism in the VAT mode has been highlighted in various judgments, including those of this Court. Reference can be made to Pakistan Beverage Ltd. v. Large Taxpayer Unit Karachi 2010 PTD 2673 (DB), applied in Pakistan International Airlines Corporation v. Pakistan and others 2015 PTD 245 (SB). In general (and subject to what is stated further and other qualifications not presently material), a person is entitled, in relation to any given tax period, to adjust input tax paid by him against any output tax due from him. Input tax is defined in rather broad terms in section 2(14). In the present case, the tax levied on the supply of cottonseed in terms of Rule 58Y(1) (assuming for the moment that such a levy would be lawful) would constitute the output tax for the cotton ginning units. They would therefore ordinarily be entitled to adjust input tax against this output tax and be liable only for the difference. It is true that section 8 provides various categories of goods and cases where input tax cannot be claimed. Clause (b) of subsection (1) specifically empowers the Federal Government to notify any goods or services in respect of which input tax cannot be claimed. It is also true that the opening paragraph of SRO 188 refers to this provision (i.e., section 8(1)(b)). However, the manner in which Rule 58Y(3) is drafted is contrary to this provision. The reason is that Rule 58Y(3) is drafted with reference to the output tax, whereas section 8 is limited only to the input tax. This is not merely a matter of semantics. What Rule 58Y(3) purports to do is to identify the output tax in respect of which input tax cannot at all be claimed. But what section 8(1)(b) empowers the Federal Government to do is to identify the goods or services the supply of which, if taxed, would not count towards input tax. In our view, since section 8 derogates from the basic principle of VAT mode taxation output minus input tax adjustment it must be applied precisely and with specificity. Equally, the power conferred on the Federal Government in terms of section 8(1)(b) must be exercised precisely and specifically. Rule 58Y(3) does no such thing. It simply identifies a supply that results in output tax (i.e., the supply of cottonseed) and purports to prohibit or deny adjustment of any input tax in relation thereto. In our view this is contrary to the terms of section 8(1)(b) and cannot therefore be sustained..

……..

14.[13] In view of the foregoing discussion, it is clear that Rule 58X and sub-rules (1) and (3) of Rule 58Y are ultra vires the 1990 Act. The retrospective effect sought to be given to SRO 188 is also contrary to law. Since the foregoing provisions constitute, as it were, the heart of Chapter XV and provide the indispensable motor that drives the entire mechanism, the whole Chapter collapses as a result. In such circumstances, in our view it would not be inappropriate to make a suitable declaration with regard to SRO 188 in its entirety.

15.[14] Accordingly, these petitions are disposed off in the following terms:

a. Chapter XV of the 2007 Rules, as inserted by SRO 188(I)/2015 dated 05.03.2015, is declared to be ultra vires the 1990 Act and hence without any legal consequence or effect whatsoever;

b. it is declared that any sales tax collected or paid on the supply of cottonseed is unlawfully demanded/claimed, as being contrary to entry No. 81 of the Sixth Schedule to the 1990 Act;

c. the respondents/Department are restrained from making any claim or demand for payment of sales tax in terms of Chapter XV or from enforcement of any of the provisions of the said Chapter and any proceeding pending or initiated in this regard or any order made are quashed and set aside;

d. the petitioners shall be entitled to the refund of any sales tax paid in terms of or under Chapter XV; any such refund claim can be made within 90 days of this judgment and shall be processed by applying, mutatis mutandis, the relevant refund rules to the facts and circumstances of each case;

e. for the removal of any doubts, it is clarified that nothing in this judgment shall prevent the respondents/Department from taking any action (and in particular demanding or claiming any sales tax payable on any supply) which could have been taken had SRO 188(I)/2015 dated 05.03.2015 not been issued, but any such action shall be taken strictly in accordance with law (and in particular, after issuing a proper show cause notice and giving an appropriate opportunity of hearing to the concerned person).

16. The petitions are allowed in the above terms. There will be no order as to costs."

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11 Retrospective effect aspect.

12 Input tax adjustment aspect.

13 Conclusive findings.

14 Order of the Court.

Insaf Cotton has illumined that a statutory exemption could not be overridden by a notification; retrospective effect could not be sustained in respect of the notification then under scrutiny; and that the denial of input tax adjustment could also not be sustained in law in the given circumstances. It is paramount to observe that there appears to be no reference to *Mustafa Impex* in *Insaf Cotton*; *inter alia* because the honorable Supreme Court had not delivered *Mustafa Impex* at the time that *Insaf Cotton* was reserved.

6. It appears that the Impugned SRO is *pari materia* to SRO 188 and that the rationale illumined by the earlier Division Bench of this court is squarely binding in respect of the *lis* before us.

Whether *Insaf Cotton* has been set aside.

7. Mr. Shakeel Ahmed, Advocate had submitted a novel proposition to insinuate that *Insaf Cotton* had been set aside. It was suggested that *Dawn Ginning 1* had placed reliance on *Insaf Cotton*; and in turn the ambit thereof was confined to the implication of *Mustafa Impex*[15] by the honorable Supreme Court[16] vide *Dawn Ginning 2*.

8. *Dawn Ginning 1*[17] had relied upon *Insaf Cotton* and allowed the challenge to SRO 188 by concluding that the learned bench had no reason to disagree with the conclusions drawn in *Insaf Cotton*; hence the said findings were adopted in all respects. *Dawn Ginning 1*, however, was rendered post *Mustafa Impex* and the august Court dismissed the challenge thereto, vide *Dawn Ginning 2*[18], in the following terms:

> "There does not seem to be any approval of the Cabinet with regard to the issuance of the notification in question. This is a clear violation of the law laid down in the judgment reported as Mustafa Impex, Karachi & Others vs. Government of Pakistan through Secretary Finance, Islamabad and Others (PLD 2016 SC 808) and as such, no case for interference has been made out. Dismissed accordingly."

9. There can be no doubt from the foregoing that *Insaf Cotton* has not been set aside[19] and that on the contrary the challenge to SRO 188 was sustained on yet an additional ground[20]. It is imperative to record that the learned counsel for the respondents did not seek to differentiate SRO 188

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15 *Mustafa Impex & Others vs. Pakistan & Others* reported as *PLD 2016 Supreme Court 808 ("Mustafa Impex")*.

16 *FBR vs. Dawn Ginning Industries & Oil Mills and connected matters* [*CP 1028 of 2017* and connected matters] ("*Dawn Ginning 2*").

17 Authored by *Shahid Karim J*.

18 Per *Saqib Nisar CJ (as he then was)*.

19 In the manner articulated before us.

20 Although subsequently the honorable Supreme Court had been pleased to qualify the impact of *Mustafa Impex* to take effect from the period following the rendering thereof; Per *Saqib Nisar CJ (as he then was)* in *PMDC vs. Malik Muhammad Fahad & Others* reported as *2018 SCMR 1956*.

from the Impugned SRO and made no attempt to distinguish the ratio of *Insaf Cotton*, hence, the same remains binding upon us[21].

10. Section 13 of the Act provides for exemption from tax and subsection (1) thereof stipulates that notwithstanding the provisions of section 3, supply of goods specified in the Sixth Schedule shall, subject to specified conditions, be exempt from tax under the Act. The Sixth Schedule clearly places the supply of cotton seed squarely within the ambit of the statutory exemption provision. Nothing has been placed before us to suggest that the exemption granted vide the statute itself could be and / or was taken away by resort to an insertion carried out vide notification impugned before us.

11. The Impugned SRO, in its recital, makes specific reference to *Dawn Ginning 1* and *Dawn Ginning 2*, however, merely seeks to overcome the *Mustafa Impex* implication without any regard to the ratio of *Insaf Cotton*; relied upon in *Dawn Ginning 1* and unaltered vide *Dawn Ginning 2*. Such conduct has been deprecated by the superior courts and it may suffice in such regard to reproduce *Munib Akhtar J*'s dicta *pari materia* herein, as observed in *Insaf Cotton*:

> "It is a matter of regret that the opening paragraph of SRO 188 has been drafted in this cavalier and careless manner. It certainly does not reflect well on either the FBR or the Federal Government. The obvious irrelevance of most of the provisions listed tends to detract materially from what is sought to be achieved by the notification, even before the substantive content thereof is considered."

12. In view hereof, adopting the reasoning and rationale illumined by *Insaf Cotton* and in *mutatis mutandis application* of the findings thereof, we do hereby allow the subject petitions in the following terms:

a. Chapter XV of the Sales Tax (Special Procedure) Rules 2007, as inserted vide the Impugned SRO[22], is declared to be ultra vires of the Act; hence, without any legal consequence or effect whatsoever.

b. Any sales tax collected or paid on the supply of cotton seed is declared to have been unlawfully demanded / collected, as being contrary to Entry 81 of the Sixth Schedule to the Act.

c. The respondents are restrained from claiming / demanding any payment of sales tax in terms of Chapter XV of the Sales Tax (Special Procedure) Rules 2007, as inserted vide the Impugned SRO, or from enforcement of any of the provisions therein

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[21] Per *Sajjad Ali Shah CJ.* in *Multiline Associates vs. Ardeshir Cowasjee & Others* reported as *1995 SCMR 362*.

[22] SRO 253(I)/2019 dated 26.02.2019.

contained and any proceedings pending / initiated in such regard and / or order made is hereby set aside.

d. The petitioners shall be entitled to the refund of any sales tax paid in terms of or under Chapter XV of the Sales Tax (Special Procedure) Rules 2007, as inserted vide the Impugned SRO. Any such refund claim may be made within 90 days hereof and shall be processed by applying, *mutatis mutandis*, the relevant refund rules to the facts and circumstances of each case.

e. However, it is clarified that nothing herein shall prevent the respondents from taking any action, which could lawfully have been taken had the Impugned SRO not been issued, but any such action shall be taken strictly in accordance with law, after issuing a proper show cause notice and giving an appropriate opportunity of hearing to the concerned person.

JUDGE

JUDGE