IN THE HIGH COURT OF SINDH AT KARACHI

(Extraordinary Reference Jurisdiction)

I.T.R.A. Nos. 141 to 144 of 2016

Date	*Order with signature of Judge*

Present:

Mr. Justice Aqeel Ahmed Abbasi
Mr. Justice Mahmood A. Khan.

Hearing of Case

1. *For orders on CMA No.179/2016 (Exemption)*
2. *For hearing of Main Case.*

Date of hearing	:	12.12.2019 and 07.07.2020
Date of Judgment	:	10.07.2020
Applicant	:	Allied Engineering & Services Ltd. Through Mr. Arif Muhammad Khan Advocate
Respondents	:	Mr. Altamash Faisal Arab. Advocate

JUDGMENT

The above four reference applications have been filed by the taxpayer against the combined order dated 29.01.2016 passed by the Income Tax Appellate Tribunal in ITA No.789/KB-2011 (Tax year 2005), ITA No.790/KB-2011 (Tax Year 2006), ITA No.791/KB-2011 (Tax Year 2007) and ITA No.792/KB-2011 (Tax Year 2008), whereby, four appeals of the taxpayer against the combined order No.318, 319, 320 & 321/A-1, dated 28.02.2011 passed by the Commissioner Inland Revenue (Appeals-1), Karachi, against the applicant, have been dismissed, whereas, Notices were issued in respect of following three questions vide order dated 23.11.2016 to the respondent to be answered in these references filed under Section 133(1) of the Income Tax Ordinance, 2001:-

1) That whether the expenses attributable to the PTR income, could be allowed as business expenses in the light of the provisions of the Income Tax Ordinance 2001, (Particularly section 2 (29), 11, 20, 21 and 56).

2) That whether the Tribunal was right in holding that the provisions of section 8 and section 169 implied that the expense even rightfully incurred for earning the PTR income could not be allowed under section 11 and 20 and that such expenses had therefore to be disallowed in the Assessment, inspite of its absence from section 21.
3) That whether Tribunal was justified in allocating the business expenditure between the FTR income and the non-FTR income and disallowing the PTR part, inspite of the decision in Moller's case which is binding on it.

3. Briefly, the facts as noted by the Tribunal and as stated by the applicant in the statement of account in these references are that the applicant public limited company is engaged in the business of import and trading of power generating sets, parts and also providing maintenance and other related services to its customers. Returns of taxable income for Tax years 2006 were filed by the Taxpayer declaring income at Rs.10.875 (M) – having business loss therein at Rs.(2.275 M). Assessment was treated to have been made under section 120 of the Income Tax Ordinance, 2001 (the Ordinance). However, the said assessment was considered to be erroneous and prejudicial to the interest of revenue and need for amendment of assessment was felt under section 122(5A) of the Ordinance was accordingly issued to provide the Taxpayer opportunity for submitting objections on the issues, for compliance due on 28.10.2009.

Being aggrieved with the action of the Addl. CIR, the taxpayer filed appeal before the Commissioner (Appeal), who vide his order dated 28.02.2011 confirmed the impugned order in the following words;

> "The ratio of decisions of the judgments support the action taken by the learned Additional Commissioner of Income Tax, as such the addition as made by the assessing officer call for no interference which is hereby **confirmed**.
>
> **Additions from expenses for Indenting Commission:** This ground has not been pressed by the learned AR as such the action of the assessing officer is hereby **confirmed**.
>
> **Credits for payments of taxes not allowed**: The learned Assessing officer is directed to allow the credit of tax deducted/paid by the taxpayer after proper verification from

> the DPC in accordance with law and procedure of the department."

Being dissatisfied with the order of the Commissioner (Appeal), the appellant/taxpayer came up to this forum for redressal of his grievances.

4. The Appellate Tribunal through impugned order after hearing both the parties while dealing with the legal issue involved in the instant references has emerged through questions proposed hereinabove by the applicant relating to proration of expenses in terms of Section 67 of the Income Tax Ordinance, 2001, read with Section 13 of Income Tax Rules 2002, has been pleased to confirm the treatment meted out by the two forums below and dismissing the appeal of the applicant, therefore, being aggrieved by such treatment as meted out by the Appellate Tribunal in respect of proposed questions, the applicant has filed instant reference applications with the request to set-aside the impugned order and decide the references in favour of the applicant.

5. Learned counsel for the applicant in addition to verbal submissions, has also furnished the brief written synopsis of such arguments, the same can be summarized in the following terms:-

It has been argued by the learned counsel that while passing the impugned orders, the Appellate Tribunal as well as the Tax Authorities have violated and ignored the mandatory directions of the law as contained in Section 11 of the Income Tax Ordinance, 2001, which has rendered their orders as a "Nullity" in the words of the full Court of the Hon'ble Supreme Court of Pakistan (PLD 1992 SC 723).

> 1. One of the basic concepts of the Income Tax Law is that every income which is subject to tax, must be taxed only after deducting its admissible and relevant expenditure.
>
> It is against the basic and fundamental concept of the Income tax law that only the gross receipt would be subjected to tax, but the legally permissible and allowable expenditure incurred for it would not be allowed.

2. When we read section 11(2) along with the definition of income under section 2(2() and 18 of the Income Tax Ordinance 2001, the PTR receipts become a necessary part of the business income of the applicant, and the PTR expenses necessarily follow suit to become a part of the business expense. These expenses have always fulfilled the requirements of section 20, and as such have never been disallowed. Factually speaking, for more than 20 years now, the Tax Department has always determined these expenses to be the "allowable expenses" in every assessment order. By allocating them as PTR expenses every year in the assessment order, the Department has tacitly been accepting the argument of the applicant which has always been agitated before them over the years.

3. That section 11(2) of the Income Tax Ordinance 2001, is a mandatory provision. Its directions will have to be strictly followed. It first requires all the business receipts and all the business expenses to first be amalgamated separately, and then the total business expenses so amalgamated have to be set off against the total amalgamated business receipts, and the balance income has then to be carried forward as "total income" and "taxable income" for the purpose of levying the charge of tax under section 4. But before this happens, section 169(2)(a) in and takes away the gross PTR receipts, to be separately taxed under the PTR provisions, and section 169(2)(b) comes in and prohibits that the PTR expenditure shall not be adjusted against those PTR receipts. This is the mandatory order of the statute – and it has necessarily to be obeyed.

   The results is that the head of Business income under section 11(2) is now left with the total Business receipts minus the PTR receipts, and the total Business expenses continue to include the PTR expenses, because there is no statutory direction regarding these PTR expenses.

   Now what will be legal position of the income under the head "income from Business under section 11(2) at this stage. There is no law whereby allowable

> expenses can be disallowed, and even the allocation of expenses cannot now be made, because of Moller's decision which is binding on the Tax department under Article 189. At the same time section 11(2) also cannot wait and has to take the next step forward as required by Law.
>
> In view of the facts and law as submitted hereinabove, section 11(2) appears to have no other alternative than to accept and set-off these expenses against the gross business receipts and it and where the expenses exceed the receipts, the loss will have to be computed, as required by section 11(3), for onward transmission to section 56.—This is also the plain requirement of section 11(2).

6. Learned counsel for the applicant has also referred to the case of Elahi Cotton Mills Ltd. v. Federation of Pakistan and others (PLD 1997 SC 582) and referred to para-41 (page 687), wherein, according to learned counsel, it has been held that only inconsistent provision of law to be excluded and not the other provisions which are consistent to provisions of the Income Tax Ordinance, 1979. Relevant finding reads as follows:-

> "41. We may observe that during the course of arguments, the question arose, as to whether in view of non obstante clause in section 80-D, an assessee can carry forward loss under section 35 of the Ordinance from year to year. Mr. Ilyas Khan, the learned counsel for the Income Tax Department, has orally as well as in his written submission answered the above query in the affirmative. It appears to be correct legal position. It may be stated that non obstante clause in section 80-D is for the purpose of liability to pay minimum tax of half per cent. on the annual turnover. This will exclude any provision of the Ordinance which may be inconsistent with it. But the same does not exclude the application of other provisions of the Ordinance which are not inconsistent with section 80-D. There seems to be no conflict between above section 80-D and section 35 of the Ordinance, and hence the same remains available to assessees. To claim business loss or to carry forward the same under section 35 of the Ordinance from year to year, is not affected by the above levy of half per cent. on the annual turnover under section 80-D as was submitted by the

learned counsel for the Income Tax Department, Mr. Ilyas Khan, orally as well as in his written submissions."

Learned counsel for the applicant has also placed reliance in the case of A.P. Moller through Agent v. Taxation Officer of Income Tax and another [(2011) 104 Tax 78 (H.C. Karachi)] and has referred to para 52(c) of the judgment, which reads as follows:-

> " (C) Income Tax Ordinance 2001 (XLIX of 2001) – Sections 7 & 101 – Tax on shipping and air transport income of a non- resident person – Phrase "subject to this Ordinance" as used in section 7 of Ordinance – Meaning & Scope – Whether such phrase would be mean that in case of conflict between anything else contained in Income Tax Ordinance 2001 on one hand and section 7 thereof on other hand, latter must give way and other provision would prevail – Held yes – Whether When no such conflict existed, then such phrase would do nothing – Held yes.
>
> As these judicial observations indicate, the phrase "subject to" merely makes clear which provision is to prevail in case there is a conflict between two provisions. It does not however, in and of itself necessarily mean that there it or will be a clash or conflict between the dominant (or master) provisions on the one hand, and the subject provisions on the other. And it certainly does not mean that the provision being made "subject to" is to be applied as though every other provision of the statute is to be read into it. In our view, the use of this phrase in section 7 cannot therefore mean that is provisions are to be applied only by, and after, reference to the other provisions of the 2001 Ordinance. Nor does it mean that the other provisions of the 2001 Ordinance are to be read or incorporated into section 7. It is only if there is a conflict between anything else contained in the Ordinance and section 7 that the latter must give way, and the other provision prevail. It is therefore, in principle, wrong to incorporate section 101 into section 7 by placing reliance on the phrase "subject to", or to conclude that the latter section must, on acco0nt of these

> words, be read and construed only with reference to the former. The subjection of section 7 to "this Ordinance" would only apply if there were a conflict between section 101 on the one hand and section 7 on the other. If there is no conflict, then "the phrase does nothing".
> International judicial consensus is clear that DTAs are to be construed broadly and liberally.

Further reliance has also been placed by the learned counsel for the applicant in the case of **Government of Sindh through Secretary & Director General, Excise & Taxation and another {(2015) 112 Tax 57 (S.C. Pak)}** and has referred to page 65 (D), which reads as follows:-

> "(D) Administration of Justice – Act to be done in a particular manner – Concept of – Whether where law requires act to be done in a particular manner, it has to be done accordingly and not otherwise – Held yes – Whether if an act is done in violation of law same shall have no legal value and sanctity, especially when conditions/circumstances which may render such act invalid have expressly and positively been specified in law – Held Yes."

7. It has been argued by the learned counsel for the applicant that impugned treatment meted out by the Assessing Officer while prorating the expenses between normal tax regime and final tax regime in respect of allowable expenditure against business income of the applicant covered under the normal tax regime is illegal and without lawful basis as according to learned counsel, in terms of Section 2(29) the term income includes presumptive income as part of total income under the income from business. Learned counsel submitted that income fallen under final tax regime on imports is the part of the same business activity of the applicant, therefore, the expenses incurred by the applicant carry on business cannot be prorated. Per learned counsel, Section 67 of the Income Tax Ordinance, 2001, is applicable in respect of normal income of a person from various heads and not applicable in case of final tax regime. Learned counsel for the applicant has argued that the applicant has a composite business of import of power generation sets which are sold out by the applicant in the

market, whereas, repair and maintenance of the said generators is also part of the business activity of the applicant, hence the applicant has a composite business against which common expenditure are incurred which are allowable under Section 169(2)(a)(b). Learned counsel further submitted that all the allowable expenses while calculating the normal business income should be allowed and since the income from final tax regime has been ousted, therefore, expenses are also required to be excluded instead of prorating the same against normal business expenses, however, by disallowing the same without any lawful basis. It has been prayed that the impugned order may be set-aside and the questions proposed may be answered in favour of the applicant and against the respondent.

8. Conversely, Mr. Altamish Faisal Arab, learned counsel for the respondent has supported the impugned order passed by the Appellate Tribunal in the instant References as well as the orders passed under Section 122(5A) of the Income Tax Ordinance, 2001, and submitted that assesse is engaged in the business of the import of generators, the same are sold in the market to its customers who are also provided maintenance services. According to learned counsel for the respondent, the department has rightly separated the expenses in respect of indenting commission and repair and maintenance in terms of Section 67 read with Section 169 of the Income Tax Ordinance, 2001 as well as in the light of CBR Circulars No.12 of 1991 and 7 of 1992, which provides a method of prorating expenses against normal tax regime (NTR) and final tax regime (FTR) in respect of business income. It has been prayed that References filed by the applicant may be dismissed and the questions proposed by the applicant may be answered against the applicant and in favour of the respondent.

9. We have heard the learned counsel for the parties, perused the record and the combined impugned order passed by the Appellate Tribunal in the instant References. The common questions proposed hereinabove by the applicant through instant References relate to determination as to whether income earned by the applicant, including Normal Business

Income (NTR) and income falling under Presumptive Tax Regime (PTR) is part of a composite business of the applicant, which according to applicant, includes import and sales of generators in the market and also to provide services of repair and maintenance to its customers. It is also to be examined as to whether the expenses incurred by the applicant to carry on the business activity, and to earn business income, separate expenses are incurred or the expenses are in respect of some composite business of the applicant. In case it is found that the expenses incurred toward earning the income through Normal Business Income (NTR) and Presumptive Tax Regime (PTR) are common then it is to be examined as to whether that allowable expenses towards earning Normal Business Income (NTR) can be prorated against expenses incurred for the earning Presumptive Tax Regime (PTR) under Section 67 read with Section 169 of the Income Tax Ordinance, 2001. From perusal of the orders passed by the Additional Commissioner in the instant case, it appears that there is no dispute with regard to head of income from which the applicant derives income i.e. "Income from business as defined in Section 18 of the Income Tax Ordinance, 2001, which prima facie includes import and sale of the generators in the market along with repair and maintenance services provided by the applicant to its customers. None of the above business activity of the applicant, including import and sale of generators in the market, providing repair and maintenance of the same generators has been treated separate source of income other than "income from the business" as defined in Section 11(C) read with Section 18 of the Income Tax Ordinance, 2001. ***The term 'income' has been defined under Section 2(29) of the Income Tax Ordinance, 2001, to include "any amount chargeable to tax under this Ordinance, any amount subject to collection (or deduction) of tax under section 148, [150, 152(1), 153, 154, 156, 156A, 233, 233A and sub-section (5) of Section 234 and any amount treated as income under any provision of this Ordinance and any loss of income, whereas Section 11(2) of the Income Tax Ordinance, 2001 provides that subject to this Ordinance, the income of a person under a head of income for a tax year shall be the total of***

the amounts derived by the person in that year that are chargeable to tax under the head, as reduced by the total deductions, if any, allowed under this Ordinance to the person for the year under that head."

10. Under the head "**Income from business**" there seems no distinction between income derived under Normal Tax Regime (NTR) and Presumptive Tax Regime (PTR), as both are derived under the same head of income i.e. Income from business under Section 18 of the Income Tax Ordinance, 2001. Different types of income of a person for a tax year to be charged from business have been defined under Section 18 of the Income Tax Ordinance, 2001, whereas, the deductions in computing income chargeable under the head "Income from business" have been provided under Section 20 of the Income Tax Ordinance, 2001, according to which, "***subject to this Ordinance, in computing the income of a person chargeable to tax under the head "Income from Business" for a tax year, a deduction shall be allowed for any expenditure incurred by the person in the year [wholly and exclusively for the purposes of business***]", whereas, the details of deductions not to be allowed towards earning business income under the head "Income from business", has been provided under Section 21 of the Income Tax Ordinance, 2001. In other words, while computing income from business, all types of Income from business falling under Normal Tax Regime (NTR) and Presumptive Tax Regime (PTR) has to be treated as part of composite business income, whereas, all the admissible expenses (deductions) incurred wholly and exclusively for the purposes of business, are to be allowed while computing the income chargeable to tax under the head "Income from Business".

11. We may now examine the provision of Section 67 and 167 of the Income Tax Ordinance, 2001 relating to apportionment of expenses and final discharge of tax liability in respect of various transactions, wherein, tax collected or deducted is treated as final discharge of tax liability under the Presumptive Tax Regime (PTR). From perusal of Section 67(1)(a) of the Income Tax Ordinance, 2001, it is clear that **where an expenditure, deduction and allowance relates to derivation of more than one head**

of income, then expenditure, deduction and allowance can be apportioned on any reasonable basis while taking account of the relative nature and size of the activities to which the amount relates, however, it does not talk about proration of expenses within the same head of income i.e. “Income from Business”. In these cases, admittedly, the expenses claimed by the applicant towards earning the Normal Business Income have been allowed by the Assessing Officer, however, no reason, whatsoever, has been assigned by the Revenue Authorities while resorting to proration of expenses under Section 67 read with Section 169 of the Income Tax Ordinance, 2001, against NTR and PTR, and thereafter, disallowing the same without assigning any reason. Contention of the learned counsel for the applicant, under the circumstances, to the effect that if total income consists of more than one head, and the expenses incurred are not separable, then such apportionment of expenses towards Normal Business Income (NTR) and Presumptive Tax Regime (PTR) can be made in terms of Section 67 read with Section 169 of the Income Tax Ordinance, 2001, appeals to logic and close to the language of the law itself, which further suggests that, if total income is received from the same head of income i.e. Income from business as a composite business activity then, there seems no occasion for proration of expenses between Normal Tax Regime (NTR) and Presumptive Tax Regime (PTR), particularly when expenses are common and not separable. Similarly, once expenses are verifiable, and admissible in terms of Section 20 of the Income Tax Ordinance, against business income, then there seems no justification to disallow the same by simply making proration against NTR and PTR income.

12. It has been observed that assesse has taken specific plea before the Additional Commissioner, LTU, Karachi, during proceeding under Section 122(5A) of the Income Tax Ordinance, 2001, in response to Show Cause Notice issued in this regard through written reply in the following terms:-

> “In this connection your kind attention is invited to the Provisions of Circular 12 of 1991 and Circular 7 of 1992 as

> well as the Provisions of section 67 of the Income Tax Ordinance, 2001 and Rule 133 of the Income Tax Rules 2002 all of which require an allocation of expenses to be made only where the related expenses of different Sources of income are not available from the accounts and all such expenses have been merged together and cannot be separately identified. Thus where the expenses relating to expenses are to be allowed against the particular source of income and no allocation of expenses can legally be made in all such a cases."

The above contention of assesse was discarded by the Additional Commissioner, LTU, Karachi, in the following terms:-

> "c) Once, identifiable costs have been separately accounted for and debited to the respective revenues then the question of treating the same as common expenses does not arise. This treatment is in line with Board's Circular No.12 of 1991 read with Board's other Circular on the subject No.7 of 1992 and the law contained in a comprehensive Rule 13 read with Section 67 of the Income Tax Ordinance, 2001. The notes to the accounts are in conformity with the contention of the Taxpayer."

The above finding for justifying the proration of expenses between Normal Tax Regime (NTR) and Presumptive Tax Regime (PTR) is based upon two Circulars of CBR issued in respect of law relating to proration of expenses under the Income Tax Ordinance, 1979, and provisions of Rule 13 of the Income Tax Rules, 2002, read with Section 67 of the Income Tax Ordinance, 2001, however, it does not explain as to whether the above Circulars, Rule and the provisions of Income Tax Ordinance, 2001, can be invoked, if there is one composite business income, under the head "Income from Business" comprising of receipts from normal tax regime and presumptive tax regime, nor it does explain as to how the verifiable and admissible deductions, can be disallowed for any expenditure incurred by the person towards such receipts from business in terms of Section 20 of the Income Tax Ordinance, 2001, in the garb of prorating the expenses between Normal Tax Regime (NTR) and Presumptive Tax Regime (PTR). It has been further observed that while invoking the provision of Section 67 of the Income Tax Ordinance, 2001, no reasonable basis for taking account of the

relative nature and size of the activities to which the amounts relates has been adopted while apportioning the expenditure, deduction and allowances, nor there has been any reference to any Rule required to be made by the Board under Section 237 of the Income Tax Ordinance, 2001. The impugned order passed by the Appellate Tribunal also does not contain any valid reasons or justification while concurring with the finding of the Additional Commissioner, LTU, Karachi, in this regard, whereas, the reasons given to justify such treatment of prorating expenses and disallowing the verifiable admissible deductions are also extraneous to legal provisions as referred to hereinabove.

13. In view of hereinabove facts and circumstances of the case, we are of the opinion that the impugned order passed by the Appellate Tribunal relating to proration of expenses and disallowing admissible deductions in respect of composite business activity of the applicant under the head from “Income from Business” comprising of Normal Tax Regime (NTR) and Final Tax Regime (FTR) is erroneous and contrary to aforesaid legal provisions of the Income Tax Ordinance, 2001. The impugned order passed by the Appellate Tribunal on the above subject is hereby set-aside. **Consequently, the question No.1 as proposed hereinabove is answered in Affirmative, whereas, questions No.2 & 3 are answered in Negative, all in favour of the applicants and against the respondents.**

Instant reference applications are allowed in the above terms along with listed applications. Appellate Tribunal’s order stands modified accordingly.

Let copy of the judgment under the seal of the Court shall be sent to the Appellate Tribunal, for information.

JUDGE

JUDGE

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