J U D G M E N T

IN THE HIGH COURT OF SINDH, KARACHI

Present: Mr. Justice Muhammad Junaid Ghaffar
Mr. Justice Jawad Akbar Sarwana

I.T.R.A. No.210 of 2012

Commissioner Inland Revenue, Zone III, Large Taxpayers Unit, Karachi v. M/s Karachi Electric Supply Corporation

&

I.T.R.A. No.12 of 2013

Commissioner Inland Revenue, Zone III, Large Taxpayers Unit, Karachi v. M/s Karachi Electric Supply Corporation Ltd.

Applicant : Commissioner Inland Revenue, Zone-III, LTU, Karachi through M/s Munawar Ali Memon and Syed Shafqat Ali Advocates

Muhammad Masood Ahmed Gorsi, Additional Commissioner, Inland Revenue

Respondent : M/s Karachi Electric Supply Corporation Limited, through M/s. Haider Ali Khan, Hamza Waheed and Sami-ur-Rehman Advocates.

and

I.T.R.A. No.85 of 2019

Commissioner Inland Revenue, Zone-II, Large Taxpayer Unit-II, Karachi v. M/s K-Electric Limited

&

I.T.R.A. No.87 of 2019

Commissioner Inland Revenue, Zone-II, Large Taxpayer Unit-II, Karachi v. M/s K-Electric Limited

Applicant : Commissioner Inland Revenue, Zone-II, LTU, Karachi through Mr. Ameer Bakhsh Metlo Advocate.

Respondent	:	K-Electric Limited through M/s. Hamza Waheed and Sami-ur-Rehman Advocates.
Date(s) of Hearing	:	14.05.2024
Date of Judgment	:	30.09.2024

COMMON JUDGMENT

Jawad Akbar Sarwana, J: Through these four (4) Income Tax Reference Applications (ITRAs), the Applicant, (herein after referred to as "the Revenue Department") has impugned (i) Order dated 31.07.2012 passed in Income Tax Appeal No.274/KB of 2012 (Tax Year 2011),[1] (ii) Order dated 19.10.2012 passed in Income Tax Appeal No.950/KB of 2011 (Tax Year 2010),[2] (iii) Order dated 16.10.2018 in Income Tax Appeal No.388/KB of 2012 (Tax Year 2008),[3] and, Order dated 16.10.2018 in Income Tax Appeal No.1021/KB of 2011 (Tax Year 2004).[4] The above-mentioned impugned Orders passed by the Appellate Tribunal Inland Revenue ("ATIR") (except for one of the impugned Orders, i.e. the Order dated 19.10.2012, which Order arises out of an appeal filed by the Respondent Department) arise from the Respondent taxpayer, Karachi Electric Supply Corporation Limited / K-Electric Limited (herein after referred to interchangeably as "K-Electric") appeals filed by it against the Revenue Department before the ATIR. All appeals essentially concerned the Taxation Officer's decision, inter alia, on whether or not the receipt of tariff adjustment subsidy from the Federal Government availed by K-Electric for the concerned tax year constituted a part of K-Electric's turnover from the sale of electricity, which could be subject to levy of minimum tax on K-Electric under Section 113 of the Income Tax Ordinance ("ITO"), 2001.

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[1] ITRA No.210 of 2012
[2] ITRA No.12 of 2013
[3] ITRA No.85 of 2019
[4] ITRA No.87 of 2019

2. The two out of four impugned Orders dated 31.07.2012[5] and 19.10.2012[6], respectively decided the matter in favour of KESC, with the following observations made by the ATIR:

> ITA No.274/KB/2012 dated 31.07.2012
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> ". . .From the above we have concluded that Tariff adjustment is not part of turnover from business therefore could not be part of turnover for the purpose of charging minimum tax under section 113 of the Ordinance. The issue of subsidy was also decided in the case of Pakistan Broadcasting reported as 101Tax174 wherein it was held that subsidy will not be part of turnover for the purpose of turnover tax."
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> and
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> ITA No.950/KB/2012 dated 19.10.2012
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> "8. We have heard both the parties and record perused, the relevant provisions of law, i.e. section 113 of the Income Tax Ordinance 2001 and 80D of the repealed Income Tax Ordinance, 1979 are reproduced for convenience:
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> . . .
>
> 9. Plain reading of the above two provisions of law clearly indicates that (a) gross sale or gross receipts derived from sale of goods and (b) gross fees for rendering of services for giving benefits to be considered as "turnover" for the purpose of ley of minimum tax. We have observed that the receipt of tariff adjustment subsidy by the respondent tax payer from the Federal Government is on account of variation in fuel price and cost of power purchase and therefore, cannot be construed to has been received either against supply of goods or rendering of services to the Federal Government. The issue of tariff adjustment subsidy has already been settled by this bench in favor of the response vide ITA No.274/KB/2012 dated 31.07.2012.

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[5] Income Tax Appeal No.274/KB/2012 in ITRA No.210/2012
[6] Income Tax Appeal No.950/KB/2011 in ITRA No.12/2013

10. Further the issue of subsidy has also been settled in favor of the respondent [K-Electric] by this Appellate Tribunal in appeal ITA No.169/KB.2006 dated 31.07.2009 [7] operating para is reproduced below:

> "[13. A plain reading of Section 80-D shows that the intention of the legislature is to levy a minimum tax irrespective of the fact whether the categories of tax payers as mentioned in it has earned profit or not. The levy "turnover" is a wide term and in our opinion intends the receipts and accruals from the major business and trading activities of the tax payer and since law says that the turnover from all sources must be taxed it has to be from all sources and all activities of the business of the assesse.]
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> [14.] Seen in this perspective we are of the considered opinion that those sources of other income should be included in turnover of the appellant for the purpose of levy of minimum tax u/s 80-D [of the Income Tax Ordinance, 1979] which accrue in ordinary course of business and are regular in nature and following source of other income should form part of turnover:
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> 1. Rental of meters and equipment.
> 2. Late payment surcharge
> 3. Profit against service connect and maintenance.
>
> [15. Remaining receipts of other income being not in ordinary course of business and also not regular in nature would not form part of turnover, therefore, should be excluded these are:"
>
> 1. Special discount received from insurance Cos.
> 2. Rebate on electricity duty.
> 3. Scrap sale.

[7] Advocate for K-Electric submitted a Statement dated 14.05.2024 attaching the copy of the consolidated Order dated 31.07.2009 passed in ITA Nos.169 (Tax Year 2001)and 170/KB/2006 (Tax Year 2002), which is available on record.

4. Price & break down insurance fund investment income and other income].”

3. Finally, in the remaining two out of the four impugned (subsequent) Orders dated 16.10.2018 passed by the ATIR in ITA Nos.1021/KB/2011 and 388/KB/2012, which cross-referenced the earlier two impugned Orders of 31.07.2012 and 19.10.2012 of the ATIR, were also decided by the ATIR in favour of K-Electric. Hence, the Revenue Department filed four (4) ITRAs in this Court against all four (4) above-mentioned impugned Orders passed by the ATIR.

4. On 04.11.2020 and 11.11.2020 in ITRA No.87 of 2019 and ITRA No.85 of 2019, this Court framed the following questions of law for adjudication of the matter, which read as under:

In ITRA No.85/2019 (Order dated 11.11.2020)

(i) Whether the Appellate Tribunal has correctly relied upon its earlier decisions holding that subsidy/tariff is not part of turnover for the purpose of section 113 of the Income Tax Ordinance, 2001?

(ii) Whether the subsidy/tariff adjustment is not part of turnover from business for the purpose of section 113 of the Income Tax Ordinance, 2001?

(iii) Whether the Appellate Tribunal has not erred in law by not appreciating that tariff adjustment and subsidy is directly relates to sale of electricity and constituted part of turnover of the taxpayer for the purpose of section 113 of the Income Tax Ordinance, 2001?

In ITRA No.87/2019 (Order dated 04.11.2020)

(i) Whether the Appellate Tribunal has correctly relied upon its earlier decisions holding that subsidy/tariff is not part of turnover for the purpose of section 113 of the Income Tax Ordinance, 2001?

(ii) Whether the subsidy/tariff adjustment is not part of turnover from business for the purpose of section 113 of the Income Tax Ordinance, 2001?

(iii) Whether the Appellate Tribunal has not erred in law by not appreciating that tariff adjustment and subsidy is directly relates to sale of electricity and constituted part of turnover of the taxpayer for the purpose of section 113 of the Income Tax Ordinance, 2001?

5. When ITRA Nos.210/2012 and 12/2013 were taken up by this Court, no questions of law had been framed in the two earlier filed references, namely ITRA No. 210/2012 and ITRA No.12/2013. Accordingly, during the arguments of the four (4) references, we raised the same questions of law as in the earlier filed two references of 2012 and 2013, and Counsels submitted their argument on the following reframed questions in all four ITRAs as applicable:

(i) Whether the subsidy/tariff adjustment as receivable from the Government of Pakistan is to be excluded from the scope of turnover to charge of minimum tax under section 113 of ITO, 2001?

(ii) Whether the Appellate Tribunal in ITRA Nos.85 and 87 of 2019 correctly relied upon the earlier in-time decisions of the Appellate Tribunal in holding that subsidy/tariff is not part of turnover for the purpose of section 113 of ITO, 2001?

6. Since the main controversy involved in all four references in essence is common, we will decide the two questions of law mentioned above, i.e. 5(i) and 5(ii), regarding all four ITRAs through this common Judgment.

7. Learned Counsels for the Revenue Department have contended that the Tribunal has seriously erred in law and facts while passing the impugned Orders, that the Tribunal's impugned Orders are contrary to the reported Judgments of the High Courts,

and all four of the impugned Orders are therefore liable to be set aside.

8. On the other hand, K-Electric Counsels have supported the impugned Orders and have contended that they are valid and lawful. They argued that the tariff adjustment (subsidy) was excluded from the scope of turnover and did not fall within the definition of "turnover" under Section 113(3) of ITO, 2001. Thus, for the purposes of calculating gross profit/gross loss u/s 113 of ITO, 2001, not being in the nature of sales. Therefore, it was not to be considered for computing the gross profit/loss. The tariff adjustment did not form part of the turnover from business and profession; hence, the same was correctly excluded for the purposes of calculation of gross loss in terms of the first proviso to section 113, ITO, 2001.

9. Heard the learned Counsels for the parties and perused the record.

10. The question of law turns on the construction of the term "turnover" as defined in Section 113 (3) of ITO, 2001, which states as follows:

> "Section 113. Minimum tax on the income of certain persons.- (1) This section shall apply to a resident company, permanent establishment of a non-resident company, an individual (having turnover of hundred million rupees or above in the tax year 2017 or in any subsequent tax year) and an association of persons (having turnover of hundred million rupees or above in the tax year 2017 or in any subsequent tax year) where, for any reason whatsoever allowed under this Ordinance, including any other law for the time being in force —
>
> (a) loss for the year;
>
> (b) the setting off of a loss of an earlier year;
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> (c) exemption from tax;

(d) the application of credits or rebates; or

(e) the claiming of allowances or deductions (including depreciation and amortization deductions) no tax is payable or paid by the person for a tax year or the tax payable or paid by the person for a tax year is less than [one] percent of the amount representing the persons's turnover from all sources for that year.

Provided that this sub-section shall not apply in the case of a company, which has declared gross loss before set off of depreciation and other inadmissible expenses under the Ordinance. If the loss is arrived at by setting off the aforesaid or changing accounting pattern, the Commissioner may ignore such claim and proceed to compute the tax as per historical accounting pattern and provision of this Ordinance and all other provisions of the Ordinance shall apply accordingly.

(2) Where this section applies:

(a) the aggregate of the person's turnover as defined in sub-section (3) for the tax year shall be treated as the income of the person for the year chargeable to tax. 144

(b) the person shall pay as income tax for the tax year (instead of the actual tax payable under this Ordinance), an amount equal to 1[one] percent of the person's turnover for the year;

(c) where tax paid under sub-section (1) exceeds the actual tax payable under Part I, Division II, of the First Schedule, the excess amount of tax paid shall be carried forward for adjustment against tax liability under the aforesaid Part of the subsequent tax year:

Provided that the amount under this clause shall be carried forward and adjusted against tax liability for [five] tax years immediately succeeding the tax year for which the amount was paid.

(3) "turnover" means,-

(a) the gross sales or gross receipts, exclusive of Sales Tax and Federal Excise duty or any trade discounts shown on invoices, or bills, derived from the sale of goods, and also excluding any amount

> taken as deemed income and is assessed as final discharge of the tax liability for which tax is already paid or payable;
>
> (b) the gross fees for the rendering of services for giving benefits including commissions; except covered by final discharge of tax liability for which tax is separately paid or payable;
>
> (c) the gross receipts from the execution of contracts; except covered by final discharge of tax liability for which tax is separately paid or payable; and
>
> (d) the company's share of the amounts stated above of any association of persons of which the company is a member."

11. Section 113 of the ITO, 2001 imposes a minimum tax on the income of certain individuals and entities, including resident companies, permanent establishments of non-resident companies, and individuals. All four references under consideration involve K-Electric being levied a minimum tax on its income. Subsection (2) outlines the formula for determining the income of an individual or entity. It states that the aggregate turnover of the person for the tax year, as defined in subsection (3), shall be treated as the income chargeable to tax. Subsection (3) sets out the definition of "turnover", which excludes sales tax, federal excise duty, and trade discounts shown on invoices. It also excludes any amount considered as deemed income. K-Electric argued that for turnover to be determined, gross receipts must be derived from the sale of goods. Therefore, it is essential to demonstrate actual sales of goods for income to be included in the definition of "turnover" as per Section 113(3)(a) of the Ordinance.

12. The issue of whether a subsidy granted by the Federal Government to an electricity distribution company ("DISCO") whereby such DISCO's consumers benefit from the supply/sales of the DISCO and is liable to be added to the turnover for the purpose of charging of tax under Section 113 of ITO, 2001, was decided in

the affirmative by the Division Bench of the Lahore High Court in the case of *Commissioner Inland Revenue, LTO, Lahore v. Messrs. Gujranwala Electric Power Co. (GEPCO)*, 2024 PTD 440 (herein after referred to as the "*GENCO"* case) and by the Balochistan High Court in *CIR V. M/s Qesco*, 2022 PTD 1844 (herein after referred to as the "*Qesco"* case). It is pertinent to mention here that the *GENCO* case relied upon an unreported Judgment of the Division Bench of this Court dated 28.09.2023 passed by one of the members of this bench (of the High Court of Sindh) in Income Tax Case No.10/1994, *M/s Cotton Export Corporation of Pakistan (Pvt.) Ltd. v. The Commissioner of Income Tax, Companies-III, Karachi* (herein after referred to as the "*Cotton Export Corporation of Pakistan"* case) We now turn to the interpretation of law (read: Section 113 of ITO, 2001) discussed in the three cases relating to Government Subsidy.

13. In the *GENCO* case, the Division Bench of the Lahore High Court, Lahore, observed that the definition of "turnover" in section 113(3)(a) of the ITO, 2001, does not require sales to the Federal Government. It is sufficient for sales to take place to consumers, and the receipt of money in respect of the sale constitutes turnover. Evasion of tax on this basis would distort the concept of subsidy, which is a matter between consumers and the Federal Government. The Division Bench in the *GENCO* case further observed that it was on the Motion of the Federal Government that a subsidy was given to the consumers. On that basis, there was a sale of goods in favour of the consumers. Since the transaction was unique, the Court had to view the term "sale of goods" in the peculiar context and backdrop of the entire transaction. Thus, the use of the term "subsidy" was notional in the opinion of the Division Bench as the subsidy was merely in favour of the consumers, and DISCOs derived no benefit out of that subsidy. They were, in fact, recompensated fully on account of the tariff determined by NEPRA.

14. The Division Bench of the Lahore High Court, Lahore, cited and applied the above principles of interpretation to Section 113, drawn from the unreported Division Bench Judgment of the High Court of Sindh dated 28.09.2023 in the *Cotton Export Corporation of Pakistan* case. In this case, the Division Bench of the High Court of Sindh observed that Section 113 of ITO, 2001, envisaged that if payments are received voluntarily, without any legal obligation, liability, or obligation to do so, then it may not be considered as income. However, in the *Cotton Export Corporation of Pakistan*, the payment by the government was specifically intended to cover losses, and it was demanded for that purpose. Therefore, this amount received was to be considered a trading receipt and must be treated as taxable income arising from the taxpayer's business. It was an income or receipt inseparably connected with the company's business conduct and arose from that business.

15. Finally, in the *QESCO* case, the Balochistan High Court observed that the minimum tax under Section 113 was calculated as a percentage of the total turnover, which includes gross receipts from the sale of goods, services, and contracts. However, certain items such as Sales Tax, Federal Excise Duty, trade discounts mentioned on invoices, and income under presumptive or final tax regimes should be excluded from the gross receipts. In the *QESCO* case, the taxpayer was involved in the business of selling electricity to domestic, commercial, and industrial consumers. The NEPRA determined the slabs and rates. In some cases, specific categories of consumers were charged lower rates. Electricity supply companies receive a portion of the electricity price from consumers, which is lower than the NEPRA Tariff, and the remaining amount was received from the Government in the form of Tariff Differential Subsidy (“TDS”). The TDS was intended to provide relief to the end consumers. These electricity supply companies disclosed both the receipts from consumers and the Government in their audited accounts. Thus, based on the above, it was evident that TDS is

the amount receivable from the Government of Pakistan due to the difference between the price charged from the consumers, which is lower than the NEPRA Tariff, and the price notified by the NEPRA. Therefore, it was not a subsidy or grant given to the QESCO as a bailout package but constituted a revenue receipt. The Balochistan High Court opined that the amount received/receivable by electric power supply companies from the Government of Pakistan, due to the difference between the lower than the NEPRA Tariff rate charged to consumers and the rate notified by NEPRA, is not a subsidy. It represented the balance price of electricity, paid by the Government on behalf of electricity consumers to provide relief to them. The electric power supply companies received their full price of electricity sold to consumers partly from consumers and partly from the Government. Accordingly, the Balochistan High Court decided the issue favouring the Revenue Department and against the DISCO, QESCO.

16. In the present case, it is an admitted position as recorded in the Annual Audited Accounts of K-Electric submitted by Counsels of K-Electric that the National Electric Power Regulatory Authority (NEPRA) during the concerned year notified the monthly fuel cost and power purchase cost variation, which was adjustable against the consumers monthly bills as Fuel Surcharge Adjustment (FSA) to the extent of a certain amount. In the year 2010, from the sum of Rs.6,388 million, a sum of Rs.4,348 million was adjustable against consumers' monthly bills.[8] According to the 2nd paragraph of Note 35.1 of the Notes to the Financial Statements for the year ended 30.06.2010, the Federal Government securitised Rs. 4,348 million as a claimable amount against government subsidy. Thus, the Federal Government would reimburse the said amount into the accounts of K-Electric.

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[8] Page 92 of the K-Electric's Annual Report 2010, Note 35, titled "Tariff Adjustment."

17. Additionally, K-Electric itself, in its Profit and Loss Account under the heading "Revenue", showed a tariff adjustment of Rs.3,766 million as a revenue item. According to Note 35.2 of the Notes to the Financial Statements for the year ended 30.06.2010, this amount of Rs.3,766 million recorded as a revenue represented the FSA receivable determined on the billing history of comparative months of 2009. Thus, this part amount of Rs.3,766 million out of Rs.4,348 million was shown as revenue receipt in the audited accounts, also. Undoubtedly, this amount also forms part of the gross receipts of K-Electric derived from the sale of goods. We agree with the observation of the learned Division Bench in the Gujranwala Electric Power Co. case (supra) and that K-Electric is, in fact, recompensed fully on account of the tariff determined by NEPRA.

18. Another aspect worth noting from K-Electric's Annual Audited Accounts was that a "Tariff Adjustment" of Rs.10,641 million was included in the company's Balance Sheet as part of the head of "Other Receivables," indicated in the Notes to the Financial Statements for the year ended 30.06.2010, as "Considered Good" under the sub-category titled, "Due from the Government of Pakistan in respect of tariff ~~adjustment~~."[9] Accordingly, this suggested that, ultimately, K-Electric would not suffer a loss of income, as the Federal Government would make up for any shortfall of tariff adjustment.

19. The principle of applicability of Section 113, ITO, 2001 to the case in hand, was well-articulated by the Taxation Officer's Amended Assessment Order for the tax year 2011 dated 14.02.2012, which was almost a decade before and consistent with the interpretation of "turnover" discussed in the Judgments of the High Courts of Pakistan in the *GENCO*, *Cotton Export Corporation*

[9] Page 75 of the K-Electric's Annual Report (ibid.)

of Pakistan and *QESCO* cases. The relevant paragraph worth repetition is reproduced herein below:

> "In the case of taxpayer, amount received as tariff adjustment is part of business receipts which are received in lieu of reduction of electricity tariff. The taxpayer receives one part of revenue from the buyers/consumers of electricity and another part of the revenue on the basis of same units of electricity sold to the consumers from the Federal Government. This tariff adjustment is not in the nature of charity but it is based on the tariff fixed by the NEPRA. Hence, the amount received as tariff adjustment has direct nexus with the sale of units of electricity which is main business of the taxpayer. Had the amount not been paid by Federal Government, the same should have been collected from the general consumers of the product of the taxpayer. Therefore, the contention of taxpayer that amount of tariff adjustment should not be made part of turnover for the purpose of section 113 of ITO, 2001 is not tenable. . .."

20. Accordingly, in view of the above discussion, the first question for a determination of whether the subsidy/tariff adjustment as receivable from the Government of Pakistan is to be excluded from the scope of turnover to charge of minimum tax under section 113 of ITO, 2001 is answered in the negative, in favor of the Revenue Department and against K-Electric in all four references.

21. As the reasoning of ATIR in ITRA Nos.85 and 87 of 2019 was based on the ATIR's reasoning stated in the earlier ITRAs which reasoning we have found misplaced, the second question whether the Appellate Tribunal in ITRA Nos.85 and 87 of 2019 correctly relied upon the earlier in-time decisions of the Appellate Tribunal in holding that subsidy/tariff is not part of turnover for the purpose of section 113 of ITO, 2001 is answered in the negative in favour of the Revenue Department and against K-Electric.

22. The upshot of the above is that the Revenue Department has made out a case to set-aside the impugned Orders in all four references. Consequently all four references are allowed in the above terms with no order as to costs.

23. Office is instructed to send a copy of this Order to the learned Appellate Tribunal in terms of Section 133(5) of ITO, 2001.

Dated: 30.09.2024

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Announced by us:

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