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Tax Bulletin

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Tax

Foreword

This publication contains brief commentary on Circulars, SROs and decisions of the adjudicating authorities issued during October 2024.

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Karachi
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Income Tax Ordinance, 2001

A. Notification:

1. S.R.O. 1638(I)/2024 dated October 18, 2024

FBR has introduced following amendments in **Rule 81B – Active Taxpayer s List** (ATL) of the Income Tax Rules, 2002 (the Rules):

- Person's name shall be included in the ATL, if he files return of income for the latest tax year, by the due date specified in section 118 or by the due date as extended by the Commissioner under section 119 or by the due date as extended by the Board under section 214A of the Ordinance.
- In case a person files his income tax return for the latest tax year, after the due date or extended due date, his name shall be included in the ATL, when he pays surcharge as specified in proviso to clause (a) of sub-section (1) of section 182A of the Ordinance.
- ATL shall remain valid on the next day after the due date or the extended due date.
- Now the ATL shall be updated on a daily basis.
- Name of a company or an association of persons, whose return is not due to be filed because of incorporation or formation of such company or association of persons, after the 30th day of June relevant to the latest tax year, shall be included in the ATL.

2. S.R.O. 1734(I)/2024 dated November 1, 2024

Through this notification it has been notified that the double tax treaty was signed between Republic of Pakistan and Republic of Latvia with respect to taxes on income and prevention of tax evasion and avoidance. Provision of the convention shall have effect:

(1) In Pakistan

- Taxes withheld at source in respect of amount paid or credited on or after the first day of July next the following the date upon which the convention enter into force.
- Other Taxes in respect of taxable years beginning on or after the first day of July next following the date upon which the convention enter into force.

(2) In Lativa

- Taxes withheld at source on income derived on or after the first day of January in the calendar year next following the year in which convention enter into force.
- Other Taxes on income and taxes on capital, for taxes chargeable for any fiscal year beginning on or after the first day of January in the calendar year next following the year in which convention enter into force.

B. Reported Decisions

1. POWER OF APPELLATE TRIBUNAL UNDER SECTION 131(5) ARE NOT SUBJECT TO ANY CONDITION / LIMITATION WHILE GRANTING STAY ON RECOVERY OF THE TAX ASSESSED

W.P. No.50303 of 2024

LAHORE HIGH COURT

MUHAMMAD ZUBAIR

VS

FEDERATION OF PAKISTAN, ETC

APPLICABLE SECTIONS: 131(5)

Brief Facts:

In the instant case, question of law has been involved and discussed regarding the imposition of condition on grant of stay under section 131(5) of the Income Tax Ordinance, 2001.

Case was taken to High Court based on the record that reflects multiple stay orders granted for 30 – 60 days with a condition to pay certain percentage of tax demand beforehand. The Petitioner adopted a stance that section 131(5) does not visualize any condition for grant of stay and the discretion exercised by the Appellate Tribunal by imposing conditions in these matters is unlawful. He further contends that power to grant stay is unhindered and the same cannot be evaded by imposing the impugned condition. The department had a view the Appellate Tribunal is possessed of discretionary power to stay recovery of any tax due by virtue of any order being assailed, subject to restrictions or limitations and the impugned conditions in the instant cases depict only reasonable exercise of judicial discretion.

Decision:

LHC held that Appellate Tribunal is the first extra-departmental/independent forum for deciding the disputes *vis-à-vis* tax liability under the Ordinance. It is clear from the provision of 131(5) that the authority of the Appellate Tribunal to grant stay during pendency of appeal before it is not conditioned by the requirement of deposit or payment of certain amount of tax determined by the forum below. In that way, the above provisions are quite distinct and distinguishable from subsection (10) of section 133 of the Ordinance which restricts or limits authority of this Court to stay recovery of tax, while a Tax Reference is pending, subject to deposit with the assessing authority of not less than 30% of the tax determined by the Appellate Tribunal.

LHC further held that such discretion ordinarily should be exercised to stay recovery of the tax impugned except for the tax liability admitted or not challenged by the appellant or the one determined on the basis of binding precedent of this Court or the Supreme Court on any issue raised in the appeal. It was further noted by the Court that the impugned conditions in the orders assailed in these petitions have been imposed by the Appellate Tribunal in a slipshod manner that hardly shows application of mind on part of the Appellate Tribunal, therefore, the same are manifestly arbitrary and of no legal effect.

2. POWER OF OFFICER TO RECOVER DEFAULT SURCHARGE THROUGH FRESH NOTICE AFTER WINDING UP RECOVERY PROCEEDINGS

2024 PTD 1218

SINDH HIGH COURT

CHINA POWER HUB GENERATION COMPANY (PVT.)

VS

PAKISTAN THROUGH SECRETARY MINISTRY OF FINANCE AND OTHERS

APPLICABLE SECTIONS: 205(3), 161, 137, 153

Brief Facts:

In the instant case, the China Hub (Petitioner) filed constitutional petition against the impugned Show Cause proceedings initiated under section 205(3) for payment of default surcharge after winding up of the recovery proceedings initiated under section 161 for taxes not deducted being withholding agent under section 153 for the tax years 2017, 2018 and 2019.

The petitioner contended that after paying the adjudged amount as per a demand notice under Section 137(2) on March 12, 2020, the subsequent notices issued for default surcharge lack lawful authority and jurisdiction. The matter was contented before the High Court with a view that after payment of the entire amount as demanded in the Order under section 161, separate notice for recovery of default surcharge cannot be issued which was never adjudicated by the officer concerned.

On the other hand, department counsel emphasized that although the petitioner eventually paid the tax amount after receiving orders, this does not absolve the petitioner from liability for default surcharge. The department contented that the petitioner did not withhold the tax initially, they are still liable for additional penalties (default surcharges) as prescribed by law, hence, the impugned Show Cause Notice for recovery of default surcharge is in accordance with law for payment of Default Surcharge.

Decision:

The Court held that:

- Firstly, default surcharge is not mandatorily payable as it has to be adjudicated upon and this adjudication has to be done along with the main order being passed in terms of s.161 of the Ordinance.

- If not, then in each and every case, which culminates after legal proceedings by way of Appeal and Reference as provided under the Ordinance, a new show cause notice would be issued in a mechanical manner, that since the litigation has ended against a taxpayer, then he is liable for payment of default surcharge as provided under section 205 ibid. This with utmost respect is an incorrect approach by the Respondents.

- It is the officer concerned having jurisdiction who has to first issue a combined notice under section 161 read with section 205 of the Ordinance, confronting a taxpayer as to why the amount of tax not withheld or deducted be recovered and further as to why in failure to do so, the default surcharge be also recovered.

- In our considered view, there cannot be separate or independent proceedings under both the sections. If it is a case of confronting a taxpayer under section 161 then it has to be done simultaneously.

- Matter has been finally adjudicated without imposing any default surcharge, hence, subsequent proceedings initiated by way of another show cause notice cannot be sustained and by no stretch of imagination, subsequent notice for the same issue under the same provision can be justified.

- Further aspect of this case is provided in proviso of section 205(1), which says that if a person opts to pay the tax due on the basis of an order under s.129 i.e. decision in Appeal by the Commissioner on the 1st Appeal on or before the due date given in the notice under section 137(2) issued in consequence of the said order and does not file an appeal under section 131, he shall not be liable to pay default surcharge for the period beginning from the date of the order under section 161 to the date of payment.

- Here in the instant matter, the Petitioner, notwithstanding to what has been held hereinabove, has paid the amount adjudged through an order section 161 pursuant to a demand notice under section 137(2) without even resorting to 1st Appeal in terms of section 129 of the Ordinance.

- Lastly, imposition of default surcharge should be adjudicated, based on willful default and presence of mens-rea.

- It is suffice to say we have come to the conclusion that the impugned Show Cause Notice(s) itself was without jurisdiction and is to be set-aside / quashed.

3. TELECOMMUNICATION SERVICES DO NOT FALL UNDER THE AMBIT OF INDUSTRIAL UNDERTAKING

(2024) 130 TAX 90

APPELLATE TRIBUNAL INLAND REVENUE

PAKISTAN MOBILE COMMUNICATIONS LTD.

VS

COMMISSIONER INLAND REVENUE (ZONE-IV), LTU, ISLAMABAD

APPLICABLE SECTIONS: 2(29C), 97(4)(b)(1), 113C, 120(1)(b), 122(5A), 122(9), 148, 210, 211, 211(2)

Brief Facts:

The Appellant is engaged in deriving income from providing cellular telecom services. The Commissioner issued a show cause notice under section 122(9) read with section 122(5A) of the Ordinance.

The appellant submitted that:

- The telecommunication services fall within the purview of the term 'Industrial undertaking' as defined in section 2(29C) of the Ordinance.
- The transactions made by the Appellant with its wholly owned subsidiary qualifies to be accepted under section 97 of the Ordinance.

The Commissioner, being unconvinced with the explanation offered by the Appellant proceeded to amend the deemed assessment order under section 122(5A) of the Ordinance.

Being aggrieved, the Appellant preferred an appeal before the CIRA who confirmed the order of the Commissioner. Aggrieved with this order, the Appellant preferred an appeal before the ATIR.

Arguments:

The Appellant submitted that it is engaged in the provision of telecommunication services. The process of provision of telecommunication services involves subjection of voice and data to a process which changes their nature for transmission into different materials and then re-converts them to voice and data at the time of delivery to the recipients. This process of conversion and reconversion of voice and data renders these materials to undergo a change that substantially changes their original condition.

The Appellant further submitted that in the telephone exchanges electrical energy is converted into electro-magnetic waves to provide service to its customers. As a sequitur, it was contended that a new product is manufactured. It was also canvassed that the activities of the appellant are in the nature of business and trade.

The Appellant had declared exempt accounting income which included accounting gain on disposal of assets to Deodar (Private) Limited which was a wholly owned subsidiary of the Appellant. It is also an admitted fact that the Appellant is a part of foreign entity VEON Group. The Appellant did not pay any income tax on the gain on disposal of assets to Deodar (Private) Limited relying on the provisions of section 97 of the Ordinance.

Decision:

The ATIR decided the matter in favour of the department as follows:

- **Industrial undertaking -** Electrical energy is converted into electro-magnetic waves does not detract from the fact that the appellant is providing only service to its customers and nothing more. In the process, no goods are being manufactured. Unlike goods, the electro-magnetic waves are neither delivered to the customers nor consumed by them.
- An undertaking to be considered as an industrial undertaking, the total activities of the undertaking should be that of manufacturing or processing of goods and even if the undertaking is engaged in some other activities also, the primary activity of the said undertaking should be that of manufacturing or processing of goods
- In Bharat Sanchar Nigam Ltd. and Anr. v. Union of India and Ors [*Case No. Writ Petition (civil) 183 of 2003 decided by SC India on 2 March 2006*], the principal question to be decided was the nature of the transaction by which mobile phone connection is made available by the telecom company to the consumers, namely, is it sale or is it a service or is it both. The Supreme Court of India held that

the appellant was not carrying out any process of manufacturing of goods or supply of any goods; it was simply rendering service to customers.

- The basic argument of the Appellant is that the activity of Appellant comes within the purview of the words "the subjection of goods or materials to any process which substantially changes their original condition" used in clause (i) of 2(29C). It is an admitted fact that the primary and dominant object of the Appellant is providing and rendering of telecommunication services to the customers, whereas the definition of "industrial undertaking" given in section 2(29C) of the Ordinance does not include the services of telecommunication sector and therefore, by interpreting clause (i) of 2(29C) of the Ordinance, the activities of the Appellant do not fall within the purview of "industrial undertaking".

- **No gain or loss u/s 97 -** The Appellant does not meet the requirement of clause (a) of sub-section (1) read with clause (b) of sub-section (4) of section 97 of the Ordinance to meet the tax neutral criteria for transfer of assets, (requiring all the group companies to be resident companies) because of admission of the Appellant that not all the companies forming the group are resident Companies. The Tribunal further held that the purpose of section 97 is to provide relief to the resident companies only while transferring the assets between wholly - owned group of resident companies.

4. AMENDMENT UNDER SECTION 4C HAS NO RETROSPECTIVE APPLICATION FOR TAX YEAR 2023 OR FOR ANY PERIOD PRIOR TO THE DATE OF PROMULGATION OF THE AMENDMENT

(2024) 130 TAX 394

ISLAMABAD HIGH COURT

PAKISTAN OILFIELDS LIMITED AND OTHERS

VS

FEDERATION OF PAKISTAN AND OTHERS

APPLICABLE SECTIONS: 2(13), 2(38A), 4C, 147, 177, 207, 208, 209, 214

Brief Facts:

By this writ, petitioners challenged the retrospective applicability of the substituted Division II B of Part I of the First Schedule to the Ordinance, introduced through the Finance Act, 2023, effective from July 1, 2023. The effect of the impugned amendment was that super tax on some income slabs stood revised and increased retrospectively for the tax year 2023 over and above the rates that would otherwise have applied for the tax year 2023, if the amendment was not made.

All the petitions prayed for the primary and dominant relief that the impugned amendment be struck down, imposing or increasing a tax liability on retrospective basis, praying in concomitance for section 4C continued to be read down as already held in the earlier judgment titled Fauji Fertilizer Company Limited and another versus Federation of Pakistan and others in Writ Petition no. 4027 of 2022.

Arguments:

The Department objected that the Chief Commissioner at Karachi was not performing functions within the territorial jurisdiction of the Islamabad High Court and, therefore, no directions could be issued to him under Article 199 of the Constitution by this Court.

Petitioner submitted that, as the taxes collected at Karachi were to be credited into the Federal Consolidated Fund at Islamabad, the performance of the function of collection of taxes at Karachi was relatable to Islamabad and, therefore, the High Court at Islamabad had jurisdiction. For this argument, petitioner cited Asghar Hussain vs Election Commission of Pakistan, wherein the Supreme Court held that the High Court of the erstwhile East Pakistan had jurisdiction over the Election Commission because it was performing functions in connection with the affairs of the Federation with direct consequences for East Pakistan and it did not matter if

the Election Commission did not have its main office in East Pakistan.

Decision:

The IHC held as follows:

- The petitions are held to be maintainable for asking for the declaratory relief against retrospective application of the super tax rates levied or revised by the impugned amendment.
- It is declared that the impugned amendment has no retrospective application for tax year 2023 or for any period prior to the date of promulgation of the Impugned Amendment.

5. THE SALE OF COTTON YARN HAS NOT BEEN COVERED WITHIN THE RESTRICTED MEANING OF 'TEXTILE' USED IN SECTION 236G OF THE ORDINANCE

(2024) 130 TAX 84

APPELLATE TRIBUNAL INLAND REVENUE, PESHAWAR

BABRI COTTON MILLS, HABIB ABAD, KOHAT

VS

COMMISSIONER INLAND REVENUE (CORPORATE ZONE), RTO, PESHAWAR

APPLICABLE SECTIONS: 161, 205, 236G

Brief Facts:

The Appellant is a Private Limited Company engaged in the manufacture and sale of yarn. Show-cause notice was issued under section I61(1A) of the Ordinance. On the given date the Appellant produced a reply along with supporting documents and tax deduction challans. Thereafter, the assessing officer passed the impugned order under section 161/205 of the Ordinance.

Being aggrieved, the appellant filed appeal before the CIRA who decided the matter in favour of the Department. Thereafter, the appellant company preferred appeal before ATIR.

Arguments:

The Appellant explained that the appellant is a manufacturer of cotton yarn which is the intermediary goods and therefore, does not come within the ambit of section 236G of the Ordinance, hence, the appellant was not required to collect advance tax from wholesalers while selling cotton yarn.

On the contrary, the Department contended that the Appellant is a manufacturer of yarn and has made supplies partly to unregistered persons and partly to registered persons, but failed to provide evidence which could establish the fact that these persons are manufacturers.

Decision:

The ATIR decided the matter as follows:

- The word "textile" has not been defined in the Ordinance. Therefore, it must be interpreted according to its ordinary or popular sense, the sense in which they are commonly understood in ordinary parlance, and not in its primary or technical sense. It is true that the manufacture of cotton yarn is a stage earlier than the manufacture of "textiles" as understood commonly. In fact, cotton is the first stage, next comes "cotton yarn" which finally produces "textiles".
- When viewed in the context of section 236G of the Ordinance, the legislature has deliberately used the words "manufacture of textile" in the restrictive sense. Had it been the intention of the legislature to levy the advance tax on cotton yarn or any other raw materials as well then, the phrase "manufacture of textile and articles thereof' would have been used in section 236G of the Ordinance.
- The Legislature is using the word "textile" in a somewhat restricted sense and not to the enlarged one of even including a fiber, filament, or yarn itself as a textile. It is an established and settled principle, evolved through a series of judgments by the higher judicial forums of the country, that there is no room for any intendment and there is no presumption as to tax/duty and tax can only be charged on a clear verdict of the fiscal statutes.

Reliance is placed on the judgments reported as 2020 SCMR 420.

The sale of cotton yarn has not been covered within the restricted meaning of "textile" used in section 236G of the Ordinance, therefore initiation of proceedings under section 161 of the Ordinance is void ab-initio, the superstructure built based thereon automatically falls to the ground.

Sales Tax Act, 1990

A. Notifications:

1. SRO No. 1636 dated October 17, 2024

FBR has revised minimum value of supply of locally produced steel goods for the purpose of payment of sales tax on ad valorem basis. Item wise detail is as under:

No.	Goods	Previous Minimum Value of supply	Revised Minimum Value of supply
		Value Per Metric Ton (Rs.)	
1.	Steel bars and other long profiles	225,000	205,000
2.	Steel Billets	195,000	175,000
3.	Steel Ingots/bala	180,000	160,000
4.	Ship plates	172,000	154,000

Moreover, it is also clarified that sales tax will be charged on the value higher of minimum value specified above or the actual value of supply.

2. SRO No. 1643(I)/2024 dated October 23, 2024

FBR has increased the sales tax rate on import and locally supply of tractors classified under PCT headings 8701.9220 and 8701.9320 from 10% to 14% under serial number 86 of Table-1 of the Eighth Schedule of the ST Act.

3. SRO No. 1644(1)/2024 dated October 23, 2024

Through notification no. SRO 563(I)/2022 dated April 29, 2022, FBR had prescribed Rules for refund of input sales tax to manufacturers of agricultural tractors by inserting Chapter V-C to the Sales Tax Rules, 2006. The said rules were introduced in view of exemption from sales tax on supply of tractors provided through the Finance Act, 2022 to avoid increase in prices for farmers as the manufacturer could recover the inadmissible input tax against exempt supply of tractor through adding up its impact in price of tractor. In terms of said rules, the eligible manufacturer can claim refund in case the incidence of input tax in respect of which refund is sought has not been passed to the farmer.

Consequent to withdrawal of exemption from sales tax on import or local supply of tractors through the Finance Act, 2024, import and local supply of tractors is made chargeable to sales tax at the rate of 14% specified under serial 86 of Table-I of the Eighth Schedule to the ST Act. Input tax is now claimable against taxable supply of tractors, therefore, the aforesaid rules become redundant, hence withdrawn through notification no. SRO No. 1644(I)/2024 dated October 23, 2024.

B. Reported Decisions

1. BENEFITS AVAILABLE TO REGISTERED PERSON UNDER THE ACT CANNOT BE EXTENDED TO UNREGISTERED PERSON

S.T.R. No.34/2023
LAHORE HIGH COURT

THE COMMISSIONER INLAND REVENUE

VS

M/S. AN TEXTILE MILLS LTD.

Applicable provisions: Section 2(25), 73(4) of Sales Tax Act, 1990 (the Act)

Brief facts:

In the instant case, the department filed sales tax reference application with the following questions of law; primarily seeking interpretation of sub-section (4) of Section 73, in the context of the scope and effect of section 2(25) of the ST Act specifically regarding the benefits available to registered versus unregistered persons:

- *Whether on the facts and circumstances of the case Ld. ATIR was justified to entitle benefits of a registered person to the persons liable to be registered in terms of Section 2(25) by ignoring the proviso attached to Section 2(25) and by bypassing the express provisions set out in Section 73(4) of the Sales Tax Act, 1990?*

- *Whether on the facts and circumstances of the case Ld. ATIR was justified to overstep express provisions of law provided u/s 73(4) of the Sales Tax Act, 1990 and strike down the demand under the garb of 'liable to be registered' as provided u/s 2(25) of the Sales Tax Act, 1990?*

Sub-section (4) of section 73 intends to disallow input tax as attributable to taxable supplies in excess of Rs.100 million in a financial year and Rs.10 million in a month, made by the registered manufacturer to unregistered person. The respondent taxpayer argued that input tax adjustment cannot be disallowed in respect of supplies made to person liable to register but not registered as such person is deemed to be registered person in term of Section 2(25) of ST Act. Negligence of the department to effect registration of an eligible person cannot be instrumental in denying benefit to the respondent, who is entitled to seek input tax adjustments against supplies made to persons liable to be registered, irrespective of the monetary limits prescribed under section 73(4) of the Act.

Decision:

The Hon'ble Court decided the instant Sales Tax Reference in favour of the applicant department reinforcing that benefit available in case of registered person cannot be extended to unregistered persons who is liable to be registered. The Court held that section 73(4) is a specific provision dealing with unregistered persons and admissibility of input tax, and it prevails over the broader definition provided in Section 2(25) of the ST Act.

The Court noted that the definition clause should not override specific provisions of the law that deal with concrete circumstances. The Court pointed out inconsistencies in the respondent's claims, noting that if the person receiving supplies was deemed not be registered for other tax purposes including chargeability of further tax, they could not simultaneously be treated as registered for the purpose of input tax benefits.

The Court found that the Tribunal had misinterpreted the provision of Section 73(4) and erred in giving preference to Section 2(25), concluding that the justifications for granting benefits in case of unregistered persons were deemed illegal.

2. FBR'S REQUIREMENT FOR A "GOOD FOR PAYMENT" CERTIFICATE IN ADDITION TO THE POST-DATED CHEQUE IS ULTRA VIRES TO ENTRY NO. 152 AND THUS ILLEGAL

2024 PTD 1258
PESHAWAR HIGH COURT

M/S YAR STEEL MILLS

VS

THE FEDERATION OF PAKISTAN

Applicable provisions: Entry No. 151 and 152 to Sixth Schedule of the Sales Tax Act, 1990 (the Act)

Brief facts:

M/s Yar Steel Mills, a sole proprietorship owned by Ameer Rahman, filed a constitutional petition challenging the requirement imposed by FBR to provide a post-dated cheque accompanied by a "Good for Payment" certificate from a bank for the clearance of imports destined for consumption in the erstwhile Federally Administered Tribal Area (FATA).

The petitioners contended that based on Entry No. 151 of the Sixth Schedule to the ST Act, the only requirement was to provide a post-dated cheque, and that the additional condition was illegal and unconstitutional.

The petitioner argued that before the 25th amendment to the Constitution, their activities were immune from income and sales tax, and that the post-dated cheque was intended as security to ensure that imported goods would be used within FATA, consistent with the exemption granted under the Sales Tax Act.

During the proceedings, the petitioner provided evidence to demonstrate operational capacity, including substantial electricity bills, which indicated financial ability to meet any potential tax liabilities. It was also established that the petitioner's manufacturing unit was situated in a region that was previously resistant to the imposition of such taxes.

Decision:

The Court disposed of the writ petition, affirming that the petitioner only needed to provide a post-dated cheque for clearance of goods without the additional banking requirement. The Court held that FBR's requirement for a "Good for Payment" certificate in addition to the post-dated cheque was ultra vires to Entry No. 152 and thus illegal.

The Court examined the legislative intent behind Entry No. 152 and concluded that there was no mandate for a "Good for Payment" certificate to be required along with the post-dated cheque. The judgment recalled that the legislature only prescribed a post-dated cheque for the purpose of ensuring that imported goods would be consumed as specified.

The Court further highlighted that FBR's demand for an additional certificate not only exceeded the legislative intent but also imposed unreasonable restrictions on the petitioner's ability to conduct business, violating the right to conduct lawful trade under Articles 4 and 25 of the Constitution.

3. NO DEMAND FOR FURTHER TAX UNDER SECTION 3(1A) CAN BE CREATED ON SUPPLIES TO UNREGISTERED CUSTOMERS WTHOUT CONDUCTING AUDIT UNDER SECTION 25 OF THE ACT

(2024) 130 TAX 77
Appellate Tribunal Inland Revenue

M/S. GREAT YUEMEI (PVT) LTD

VS

THE ADDITIONAL COMMISSIONER INLAND REVENUE

Applicable provisions: Section 3(1A),11(2),(11(4),25,25(3),33(5),34(1)(a) and 72B of Sales Tax Act, 1990 (the Act)

Brief facts:

In the instant case, the registered person who is a retailer filed sales tax return for the period December 2021 to June 2022 whereby the tax department identified discrepancies related to the sales invoices, which only declared a single product (cotton yarn with HS Code 5207) and indicated that the registered person was operating as a spinning mill manufacturing yarn. Based on these observations, the department passed the order demanding further tax under section 3(1A), along with a default surcharge and penalties as per sections 34(1)(a) and 33(5) of the ST Act.

The registered person objected that the order was passed regarding further tax under section 3(1A) without conducting an audit as the jurisdiction of assessment of further tax lies under section 25 rather than section 11(2) of the ST Act. Moreover, the registered person is a retailer duly integrated with the e-portal of FBR and sells goods to the end consumers therefore as per S.R.O. No. 648(1)/2013, is not liable to pay further tax under section 3(1A) of the ST Act. The registered person filed appeal before the Appellate Tribunal Inland Revenue.

Decision:

The Tribunal decided the case in favour of the registered person and held that no demand can be created without auditing the record of the registered person. Therefore, the action of the Commissioner is held to be against the maxim *audi alteram partem*, as established by the Hon'ble Lahore High Court in a judgment reported as 2012 PTD 964. Section 25 clearly states that a demand cannot be created without completing an audit of the record of the registered person under section 25(3) read with section 72B of the Act.

The Tribunal further held that the action for charging further tax cannot be endorsed in the absence of concrete evidence. The Assessing Officer has not provided a single instance identifying the party/distributor/retailer and the quantum of supplies. No concrete evidence contrary to the appellant's claim has been presented by the assessing authority. Thus, in the absence of reasonable proof, the appellant's contention regarding the supply of imported goods to end consumers, not attracting further tax, appears reasonable. Consequently, the Assessing Officer's action of charging further tax on the supplies is annulled.

4. INPUT TAX DISALLOWANCE UNDER SECTION 8(1)(a) DOES NOT APPLY TO CASES WHERE INPUT / RAW MATERIALS HAVE BEEN LOST / DAMAGED , AS SUCH LOSSES DO NOT CONSTITUTE USAGE FOR NON-TAXABLE PURPOSES.

Civil Appeals. No. 947 of 2002
SUPREME COURT OF PAKISTAN

M/S MAYFAIR SPINNING MILLS LTD

VS

THE COLLECTOR OF SALES TAX & FEDERAL EXCISE

Brief facts:

M/s Mayfair Spinning Mills Ltd., a manufacturer of cotton yarn, had purchased bales of ginned cotton in December 1996 and paid input tax accordingly. However, at the time of filing of sales tax return, the company calculated output tax which appeared to be less after adjusting input tax. Therefore, the company claimed the refund.

The Tax Officer issued a show cause notice to justify the refund claim which culminated into passing of order, granting a partial refund due to some cotton bales being damaged and others destroyed in a fire, making them unusable for taxable supplies. The respondent appealed this decision, but both the Collector (Appeals) and the Customs, Excise and Sales Tax Tribunal upheld the Tax Officer's decision.

The case was subsequently taken to the Lahore High Court, where a 2:1 split decision favored the respondent. The majority opinion held that input tax can be adjusted by the taxpayer.

The Commissioner Inland Revenue then sought leave to appeal, questioning the interpretation of sections 7 and 10 of the ST Act, asserting that these provisions were misconstrued, particularly regarding the relationship between input tax and the goods purchased. The respondent-taxpayer defended the majority view, arguing that input tax may be deducted for both past and future taxable supplies without needing the goods to be actually used in production.

Decision:

The Supreme Court dismissed the appeal by the Commissioner Inland Revenue, upholding the Lahore High Court's majority opinion stating that loss of goods to fire does not invalidate the input tax adjustment claim, as the materials purchased were intended to be used for production. The Court clarified that deductions are not restricted to goods physically used in the tax period but can include intended future use.

The Court also addressed the question whether input tax deductions could be claimed under Section 7 of the ST Act for goods destroyed by fire and no longer available for taxable supplies. It was answered that registered persons can deduct input tax incurred for taxable supplies made or to be made, focusing on the following three key conditions:

- the input tax must be intended for taxable supplies,
- it can be accounted for future supplies; and
- the deductions must align with the same tax period as the output tax.

The Court further held that section 8, which disallows input tax on goods for non-taxable supplies, was not applicable since loss through destruction does not equal use for non-taxable purposes. Consequently, the tax authority's appeal was dismissed, allowing the taxpayer to claim full refund.

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Yousuf Adil, Chartered Accountants provides Audit & Assurance, Consulting, Risk Advisory, Financial Advisory and Tax & Legal services, through nearly 550 professionals in four cities across Pakistan. For more information, please visit our website at www.yousufadil.com.