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Judgment Sheet.

IN THE LAHORE HIGH COURT LAHORE JUDICIAL DEPARTMENT.

Case No. ITR No.56081/2022

Commissioner Inland Revenue Sialkot

Versus

Air Sial Limited , Sialkot

JUDGMENT

Date of hearing	**07.10.2024**
Petitioner by	Raja Sikandar Khan, Advocate.
Respondent by	M/S Barrister Muhammad Abubakar, Ch. M. Waseem Akram and Malik Nadir Ali Sherazi, Advocates.

Abid Aziz Sheikh, J.- This judgment will also decide ITR No.56083/2022, ITR No.56086/2022 and ITR No.56088/2022, as all these reference applications are against the same impugned order dated 05.4.2022 **(impugned order)** in respect of different tax years passed by Appellate Tribunal Inland Revenue **(Tribunal)**.

2. These reference applications are filed under section 133 of the Income Tax Ordinance, 2001 **(Ordinance)** against impugned order passed by the Tribunal in respect of tax years 2017 to 2020. Though number of questions of law are framed in

these reference applications, however, the following questions of law have been pressed and argued:-

1. *Whether in the facts and circumstances of the case the Appellate Tribunal Inland Revenue made a gross error in holding that profit on debt on deposit of surplus funds in banks was income from business under sub-section (2) Section 18 of the Income Tax Ordinance, 2001 notwithstanding the fact that it is not the respondent taxpayer's business to derive such income as the respondent taxpayer is not a banking company or a financial institution or a lending company or an investment company or registered as such with the Securities & Exchange Commission of Pakistan or State Bank of Pakistan?.*

2. *Whether the Appellate Tribunal Inland Revenue made a gross error in reading sub-section (5) of section 25 by holding that only the cost of feasibility studies, construction of proto types and trial production activities were included in pre-commencement expenditure whereas pre-commencement expenditure also means any expenditure incurred wholly and exclusively to derive income chargeable to tax?.*

3. *Whether in the facts and circumstances of the case the Appellate Tribunal Inland Revenue made a gross error to allow deduction of pre-commencement expenses from profit on debt which is income from other sources, whereas under section 25 of the Ordinance, 2001 pre-commencement expenses could only be allowed as amortization on a straight line basis at the rate specified in Part III of the Third Schedule?.*

3. Relevant facts are that respondent is a company deriving income from air transport services. Returns of incomes filed for tax years 2017 to 2020 were treated as deemed assessment orders

in terms of section 120(1) of the Ordinance. Later on, Additional Commissioner Inland Revenue **(ADCIR)** initiated proceeding under section 122(5A) of the Ordinance and passed order on 07.4.2021. The respondent being aggrieved filed appeal before Commissioner Inland Revenue (Appeals) **(CIR-A)** which confirmed the order of ADCIR on 13.7.2021. The respondent being aggrieved filed appeal before the Tribunal, which was partially allowed through impugned order, hence these reference applications.

4. Learned counsel for the petitioner department submits that expense incurred for deriving income chargeable to tax for the tax year 2017 to 2020 were pre-commencement expenses and therefore, lawfully disallowed and amortized by the ADCIR and CIR-A. Further submits that income on account of profit on debt was not income from business as provided under section 18(2) of the Ordinance rather the same was income from the other source under section 39(1)(c) of the Ordinance.

5. Learned counsel for the respondent assessee on the other hand supported the impugned order.

6. Arguments heard. Record perused. The first question require determination in this case is that whether income on

account of profit on debt was to be treated as income from business under section 18(2) of the Ordinance or it is income from other sources under section 39(1)(c) of the Ordinance. For convenience, Section 39(1) and section 18(1) and (2) of the Ordinance are reproduced hereunder:-

> *39.Income from other sources.---(1) Income of every kind received by a person in a tax year, [if it is not included in any other head,]*
>
> *18.Income from business.---(1) The following incomes of a person for a tax year, other than income exempt from tax under this Ordinance, shall be chargeable to tax under the head "income from Business".*
>
> *(2) Any profit on debt derived by a person where the person's business is to derive such income shall be chargeable to tax under the head "income from Business" and not under the head "Income from Other Sources".*

7. Plain reading of Section 18(2) of the Ordinance shows that any profit on debt derived by a person where the person business is to derive such income, shall be chargeable to tax under the head "income from Business and not under the head income from other sources". Whereas under Section 39(1) of the Ordinance income of every kind received by a person in a tax year if not

included in any other head shall be income from other sources. In the present case, facts are not disputed that respondent is a company established to carry on and operate air transport services as also mentioned in objects of the company under its Memorandum of Association **(MOA).** In order to achieve objects, the respondent company is also authorized to invest surplus money of the company in shares, stocks or securities etc.

8. For ready reference, the relevant objects for which the respondent company is established are all or any of the following.

> 1. To carry on and operate air-transport services or any means of transportation by aircrafts, helicopters, air taxi services, buses, railroad, wagons, coaches or ships and transport by air craft of passenger, goods of all kinds and cargo for commercial or other purposes and to carry out all forms of aerial work. To establish airlines for the purpose of transport of passengers and cargo of all descriptions and to provide air charters and such others services as may be incidental to or conveniently combined with other business or airlines on domestic as well as international route, subject to necessary remissions required from concerned authorities.
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For the purpose of achieving the above objects, the company is authorized:-

To invest surplus money of the Company in shares, stocks or securities of any company, debentures, debenture stocks or in any investments, short term and long term participation, term finance certificates or any other government or semi-government securities in such manner as may from time to time be decided by the directors, without indulging non-banking finance business, banking or an investment company or any such business.

(Emphasis supplied)

9. Admittedly, the primary object and purpose of respondent company is to carry on and operate air transport service and not to derive any profit on debt as required under Section 18(2) of the Ordinance. No doubt, for the purpose to achieve said object the respondent company was authorized to invest surplus money of

the company in shares, stocks or securities of any company, debentures, debenture stocks or in any investments, short term and long term participation, term finance certificates or any other government or semi-government securities but respondent company is specifically not allowed to indulge in non-banking finance business, banking or an investment company or any such business. The respondent company was incorporated on 06.06.2016 though certificate of commencement of business was issued on 26.08.2016, however, admittedly, date of actual commencement of business is 20.12.2020 when first sales tax return was filed, hence, the profit in question accrued on surplus money from 2017 to 2020, is before the commencement of respondent company business.

10. The similar matter came up before Supreme Court in *Lucky Cement Ltd vs. Commissioner Income Tax, Zone Companies Circle, Peshawar* **(2015 PTD 2210).** In the said case, the legal question was that whether income received by Lucky Cement Limited (**Lucky Cement**) from the investment made by it of its surplus money, into various profitable schemes/banks can be treated as income from business or income from other source. The argument of Lucky Cement counsel was that though the primary object and purpose of the company was to establish

Cement Factory and this would be ultimate business of Lucky Cement, however, since the MOA of the Lucky Cement permits investment to be made for the purpose of its business to generate income, therefore, any profit earned or income generated/ received from such investment should be taxed as income from business, as opposed to income from other sources. Out of three Hon'ble Judges of Bench, one Judge Mian Saqib Nisar, J. agreed with the above argument and held that amount of profit earned by Lucky Cement from the investment made in various schemes/banks cannot be termed to have been accrued from any other source but it is a business income. However, other two Hon'ble Judges Sh. Azmat Saeed, and Mushir Alam, JJ. gave a dissenting note and held that surplus fund investment does not amount to Business income rather same fall under the head "income from other sources" under clause (f) of section 15 of the Income Tax Ordinance, 1979 **(Ordinance of 1979)**. The operative part of the judgment by Hon'ble Mushir Alam, J. is reproduced hereunder:-

> "*On examining the scheme of the Income Tax Ordinance, 1979, case-law on the subject, consensus that emerges is that during the period or course of setting up of a factory or plant by the company, activity of investing surplus funds of the company and generating any sum, return or interest on such investment, could not be considered as "income from business" under clause (d) of section 15 of the Ordinance, 1979. Fact remains in the words of the*

> *appellant, surplus funds in the hands of appellant company were employed "in proactive manner in order to generate additional fund", invested its surplus funds "by way of portfolio, fund and cash management venture". It is appellant's case that "by an active trading (buying and selling) of these financial assets, the appellant was able to earn substantial amount by way of return". Such activity was carried out during the period cement plant/factory was under construction, therefore, the appellant, under facts and circumstances cannot be said to be carrying on any business within the contemplation of section 22 of the Ordinance, 1979. When income does not fit in any of the five sub-heads enumerated in clauses (a) to (e) of section 15 of the Ordinance, 1979 and falls under the residuary sub-head of "Income from other sources" i.e. clause (f) of section 15 ibid, the DICT, under the given facts and circumstances, was justified to treat the "interest" income yielding from the investment of the surplus funds of the company as "Income from other sources" and rightly assessed the same under section 30(2)(b) of the Ordinance, 1979, which was rightly sustained by the ITAT and so also by the learned Division Bench of the High Court".*

11. Though the aforesaid judgment is based on the scheme of Ordinance of 1979, however, we have noticed that the relevant provision of the Ordinance for the given purposes has no bearing on the majority view by the Supreme Court of Pakistan in *Lucky Cement's case supra*. In section 30 of the Ordinance of 1979, chargeable sources under the head "income from other sources" admitted interest, whereas, section 39 of the Ordinance provides that income of every kind received by a person in a tax year, if not included in any other head, other than exempted from the tax under the Ordinance, shall be chargeable to tax in that year under the head "income from other sources" includes "profit on debt".

Section 2(46)(a) of the Ordinance provides that "profit on debt" whether payable or receivable means any profit, yield, interest etc., therefore, for the present purposes majority view in *Lucky Cement's case supra* is squarely applicable.

12. The reported judgment of Islamabad High Court titled *The Commissioner of Income Tax vs. Messrs Fauji Foundation* **(2021 PTD 1951)** referred in the impugned order is distinguishable. In said case, assesse was trust and the department from 1999 to 2002 treated its interest income from bank deposits as income from business. Further in said case, this Court on 27.10.1999 in ITA No.16 to 20 of 1999 remanded the matter to Tribunal and after remand Tribunal decide the question against the department on 30.6.2000 treating interest income as business income but said order of Tribunal was not challenged further by the department, hence attained finality. The factual position of this case is altogether different from the above facts. No doubt, learned Islamabad High Court in said judgment held that *Lucky Cement Limited* case is not applicable because in MOA of Lucky Cement, there was specific prohibition against investment which is not available in the case of Messrs Fauji Foundation supra, however, in the present case respondent company by its MOA is also not allowed to indulge in investment-company or any such business.

Indeed in Lucky Cement Ltd. case supra, one of the Hon'ble Judges (Sh. Azmat Saeed, J.) also observed that under non-obstante clause 37 of MOA of Lucky Cement, there is prohibition to indulge in the business of investment, however, this was not the sole ground to treat the interest income of Lucky Cement as income from other source and not a business income. Though in the present case, there is no such specific non-obstante clause in MOA prohibiting business of banking, finance, investment, leasing and insurance, however, indulgent in investment company or any such business is specifically not allowed by MOA of respondent company. Further, there is no explicit or implied object clause in MOA of respondent company whereby any of such business activities is allowed. The respondent company is not a banking company or financial institution or lending company or an investment company or registered as such with the Securities and Exchange Commission of Pakistan (SECP) or State Bank of Pakistan **(SBP)**, rather admittedly respondent company business is to carry and operate air transport service, hence, profit on deposit of its surplus, before commencement of its business cannot be treated as income from business under Section 18(2) of the Ordinance. In view of above, we have no manner of doubt that majority view laid down by

Supreme Court in *Lucky Cement Limited case* supra is applicable to the present case.

13. It is not out of place to note that in Lucky Cement Ltd case majority Hon'ble Judges specifically relied upon judgment reported as *Commissioner of Income Tax, East Pakistan Dacca vs. The liquidator Khulna Bagerhat Railway Company Limited, Ahmadabad* **(PLD 1962 SC 128)** where it was held that interest income yielding from investment of surplus fund of the company is income from other source and not business income. The operative part of judgment from *"Commissioner of Income Tax vs. Liquidator Khulna Bagerhat"* supra is reproduced hereunder:-

> "*We have considered the various Articles by which this Company was governed. We have no hesitation in agreeing with the view of the High Court that the normal business of the Company was the construction and the running of the Railway and not investment of its moneys on interest. Other powers were also given to the Company by the Articles of Association, but it is not contended that all those powers pertained to the earning of normal business income. If the Company, instead of retaining its surplus moneys in idle condition, invested them under the powers given to them by their Articles of Association, it would not follow that the income so derived would be part of the Company's normal business income. Each case must be decided on its own facts and, in the instant case, the circumstances brought out in the evidence do not indicate that*

> *receiving of interest on invested moneys was really included in the business income of the Company".*

14. The next question is that whether the management and administrative expense from year 2017 to 2020 does not come within the definition of pre-commencement expenditure as defined 25(5) of the Ordinance. For convenience, section 25(5) of the Ordinance is reproduced hereunder:-

> *Section 25(5).In this section, "pre-commencement expenditure" means any expenditure incurred before the commencement of a business wholly and exclusively to derive income chargeable to tax, including the cost of feasibility studies, construction of prototypes, and trial production activities, but shall not include any expenditure which is incurred in acquiring land, or which is depreciated or amortized under section 22 of 24.*

From plain reading of section 25(5) of the Ordinance, it is evident that pre-commencement expenditure means any expenditure incurred before the commencement of a business wholly and exclusively to derive income chargeable to tax, including the cost of feasibility studies, construction of prototypes, and trial production activities but shall not include any expenditure which is incurred in acquiring land, or which is depreciated or amortized under section 22 or 24 of the Ordinance. The word "including" in section 25(5) of the Ordinance established that the cost of feasibility studies, construction of

prototypes, and trial production activities are not the only pre-commencement expenditure rather the said term is wide enough to include any expenditure incurred before the commencement of the business wholly and exclusively to derive income chargeable to tax.

15. The word "include" is normally used as an expression of enlargement and implies that something also falls within the word which was beyond its general organic meaning in the interpretation clauses in order to enlarge the meaning of the words or phrases occurring in the body of the statute. In one of the recent judgment of the Supreme Court of Pakistan in case titled "*Qudrat Ullah vs. Additional District Judge, Renala Khurd District Okara and others :* **(PLD 2024 Supreme Court 581),** following has been observed:-

> "*…The word "includes" is generally used in interpretation clauses in order to enlarge the meaning of words or phrases, occurring in the body of the Statute; and when it is so used those words or phrases must be construed as comprehending, not only such things as they signify according to their natural import, but also those things which the interpretation clause declares that they shall include…".*

It is also equally settled that this, however, is not rule of thumb and sometime word "include" conveys the restricted meaning. This depends upon the context in which the word "including" or

"include" is used. As already has been observed, the word "including" in section 25(5) of the Ordinance is used in the middle of the sentence and when it is read in the context, does not leave any doubt that the same is not used in the restrictive meaning rather enlarging the scope of the said subsection. The narrow and restrictive meaning given by the Tribunal to "pre-commencement expenditure" under Section 25(5) of the Ordinance is not supported by law and therefore, we are of the considered view that the expenses are covered under the head of pre-commencement expenses under section 25(5) of the Ordinance as lawfully held by ADCIR and CIR-A.

16. So far as the question No.3 is concerned, as profit on surplus fund amount to income from other sources and expenses are covered under the head of pre-commencement expenses under section 25(5) of the Ordinance as discussed above, the assessing officer had lawfully disallowed and amortized expenses against interest income under the relevant provision of the Ordinance.

17. In view of above discussion, questions are answered accordingly. Consequently, these reference applications are partially allowed and after setting aside the impugned order of

the Tribunal, on the above two questions, the orders passed by ADCIR and CIR-A are upheld.

18. Office shall send copy of this judgment under the seal of the Court to the learned Appellate Tribunal Inland Revenue as per Section 133(5) of the Ordinance, 2001.

(SULTAN TANVIR AHMAD) ***JUDGE***

(ABID AZIZ SHEIKH) ***JUDGE***

Approved for Reporting

JUDGE

Rizwan