

IN THE SUPREME COURT OF PAKISTAN
(APPELLATE JURISDICTION)

PRESENT: MR. JUSTICE MIAN SAQIB NISAR
MR. JUSTICE MANZOOR AHMAD MALIK
MR. JUSTICE KHILJI ARIF HUSSAIN

CIVIL APPEALS NO.1264 TO 1270/2006, 975/2007, 229/2010, 716, 717, 722, 723/2011, 697/2015 AND C.M.A.NO.793/2008 IN CIVIL APPEAL NO.1574/2007

(Against the judgments dated 27.1.2006/30.3.2006, 30.4.2009/15.4.2011/5.5.2011/12.11.2014 of the High Court of Sindh, Karachi passed in ITA No.178/1999, ITR No.102/1991, Ref. Case No.130/1997, ITR No.131/1997, ITA No.177/1999, ITA No.217/1999, ITA No.208/1999, ITR No.185/1997, ITA No.531/2000, ITA No.295/1997, ITA No.296/1997, ITA No.929/2000, ITA No.930/2000 & ITC No.482/2004)

Commissioner of Income Tax	...in C.A.1264/2006
Commissioner of Income Tax	...in C.A.1265/2006
Commissioner of Income Tax	...in C.A.1266/2006
Commissioner of Income Tax	...in C.A.1267/2006
Commissioner of Income Tax	...in C.A.1268/2006
Commissioner of Income Tax	...in C.A.1269/2006
Commissioner of Income Tax	...in C.A.1270/2006
Commissioner of Income Tax	...in C.A.975/2007
Commissioner of Income Tax	...in C.A.229/2010
Commissioner Inland Revenue	...in C.A.716/2011
Commissioner Inland Revenue	...in C.A.717/2011
Commissioner Inland Revenue	...in C.A.722/2011
Commissioner Inland Revenue	...in C.A.723/2011
Commissioner Inland Revenue	...in C.A.697/2015
Commissioner of Income Tax	...in C.M.A.793/2008
	in C.A.154/2007
	...Appellant(s)

VERSUS

Balochistan Concrete and Block Works Ltd.	...in C.A.1264/2006
M/s Balochistan Wheels Ltd.	...in C.A.1265/2006
M/s Automotive Battery Co., Ltd.	...in C.A.1266/2006
M/s Balochistan Wheels Ltd.	...in C.A.1267/2006
M/s Bolan Casting Ltd.	...in C.A.1268/2006
M/s Automotive Battery Co., Ltd.	...in C.A.1269/2006
M/s Automotive Battery Co., Ltd.	...in C.A.1270/2006
M/s Allied Garments Industries (Pvt.) Ltd.	...in C.A.975/2007
M/s Bolan Casting Ltd. Karachi	...in C.A.229/2010
M/s Asia Board Industries Ltd.	...in C.A.716/2011
M/s Asia Board Industries Ltd.	...in C.A.717/2011
M/s Diamond Food Industries (Pvt.) Ltd.	...in C.A.722/2011
M/s Diamond Food Industries (Pvt.) Ltd.	...in C.A.723/2011
M/s NP Spinning Mills Ltd.	...in C.A.697/2015
Shah Nawaz Textile Mills Ltd.	...in C.M.A.793/2008
	in C.A.154/2007
	...Respondent(s)

For the appellant(s): Dr. Farhat Zafar, ASC
(in all cases)

Mr. Muhammad Siddiq Mirza, ASC
Mr. Shakeel Ahmed, ASC
Mr. Muhammad Habib Qureshi, ASC
Raja Abdul Ghafoor, AOR

For the applicant(s): Nemo
(in C.M.A.793/2008)

For the respondent(s): Mian Allah Nawaz, Sr. ASC
(in C.A.1268/2006)
Mr. Salman Pasha, ASC
(in C.As.716 & 717/2011 & 697/2015)
Ex-parte
(in C.As.1264, 1270/2006 & 975/2007)
Not represented
(in C.As.229/2010, 722 & 723/2011)

Date of hearing: 16.11.2016

...
ORDER

MIAN SAQIB NISAR, J.- These appeals, by leave of the Court, involve the following questions:-

- (i) whether the losses incurred by an industrial undertaking during the period of tax holiday under the Income Tax Ordinance, 1979 (*the Ordinance*) which could not be fully set-off against the income earned during such period, can be carried forward and set-off against the income earned in the assessment years beyond the tax holiday period; and
- (ii) whether unabsorbed depreciation allowance can be carried forward to the assessment years beyond the tax holiday period.

2. The brief facts are that the respondents, industrial undertakings involved in the manufacturing of different goods, claimed exemption from charge to tax under various clauses (*particularly Clauses 118D, 119, 122 and 125*) of the Second Schedule of the Ordinance for various assessment years. However they suffered losses which could not be fully set-off against the income earned by them during the period of tax holiday and therefore claimed that such losses be carried forward and set-off against the income earned in the assessment years beyond the tax holiday period (*note:- in Civil Appeals No.716 and 717/2011 the respondents sought*

carrying forward of unabsorbed depreciation allowance). This claim was declined by the Assessing Authority. The matters came before the Commissioner of Income Tax, the Income Tax Appellate Tribunal (*the Tribunal*) and finally the learned Division Bench of the High Court of Sindh which, while deciding the tax references, held that the losses (*and the unabsorbed depreciation allowance*) sustained during the tax holiday could be carried forward against income earned thereafter. Aggrieved, the appellant/department approached this Court. Leave was granted through numerous orders to consider the questions highlighted in the opening paragraph of this opinion.

3. Learned counsel for the appellant/department submitted that losses incurred during the tax holiday period which remained unabsorbed could not be carried forward and set-off against the profits and gains earned by the respondents in the assessment years beyond such period; the learned High Court of Sindh in the impugned judgment(s) has erred by relying upon precedents regarding set-off of unabsorbed depreciation of plants, buildings, machinery etc. which was not relevant to losses sustained during the tax holiday period; the use of the word 'loss' in the definition of 'income' means that it cannot be carried forward and is confined to that particular year; and that there is no law that allows losses incurred in tax holiday period to be adjusted in the tax period. Reliance was placed upon Commissioner of Income Tax Vs. Messrs Anwar Textile Mills Ltd (1989 PTD 1016), In the matter of the Income-Tax Assessments of Messrs Sheikco Ltd., Ismailabad, Multan (PLD 1962 Lah 870), Commissioner of Income Tax, Companies Zone-I, Lahore Vs. Messrs Grays Leasing Company Limited (2005 PTD 2093), Messrs Pioneer Bank Ltd. in liquidation Official Liquidator, State Bank of Pakistan, Dacca Vs. The

Commissioner of Income-Tax, East Pakistan, Dacca (1968 PTD 520)
and **The Commissioner of Income-Tax, East Zone, Karachi Vs. Messrs Iqbal Engineering Works and another (PLD 1986 SC 556).**

4. Contrarily, learned counsel for the respondents contended that the purpose of tax exemptions was to promote and encourage certain industries; Sections 34 and 35 of the Ordinance specifically excludes carrying forward of speculation losses under Section 36 but nowhere have losses incurred during the tax holiday been excluded from being carried over; once the tax holiday period is over, the normal law comes into play on which basis assessments are to be made, and such law provides that if an assessee suffers losses he would be entitled to adjustment, irrespective of whether there were tax holidays or not; the definition of 'income' in Section 2(24) of the Ordinance includes 'loss' and hence the Assessing Officer erred in finalizing the assessment at 'nil' income without giving any findings regarding the quantum of income or loss. Reference was made to **Commissioner of Income Tax, Lahore and Chairman FBR, Islamabad and others Vs. Messrs Prosperity Weaving Mills (Pvt.) Ltd. and others (2011 SCMR 177).**

5. Heard. According to Section 14 of the Ordinance, incomes or classes of income, or persons or classes of persons specified in the Second Schedule shall be exempt from tax, under the Ordinance, subject to the conditions and to the extent specified therein, provided that, where any income which is exempt from tax under any provision of the Second Schedule, such income, as may be specified in the said Schedule and subject to such conditions as may be specified therein, shall be included in the total income, so however that the tax shall not be payable in respect of such income. Clauses 118D, 119, 122 and 125 of the Second Schedule all provide that industrial undertakings (*which*

fulfil the conditions enumerated therein) set up during various time periods were exempt from paying tax upon their profit and gains. It is undisputed that the respondent/industrial undertakings were entitled to such exemption, rather the only issue is whether they were entitled to carry forward the losses they incurred during the tax holiday period and have it set-off against the income earned in the assessment years beyond the tax holiday period. Section 34 of the Ordinance provides that:-

*“34. **Set-off of losses.**- Where an assessee sustains a loss (not being a loss to which section 36 or section 37 applies) in any assessment year under any head of income specified in section 15, he shall, subject to clause (v) of sub-section (1) of section 23 be entitled to have the amount of the loss set-off against his income (other than income to which sub-section (7) or (9) of section 12 applies), if any, under any other head assessable for that assessment year.”*

Although Section 34 *ibid* restricts the set-off of loss to the income of that particular assessment year, Section 35 of the Ordinance allows for business losses to be carried forward, the latter of which reads as under:-

*“35. **Carry forward of business losses.**- Where an assessee sustains a loss in any assessment year under the head ‘Income from business or profession’ (not being a loss to which section 36 applies) and the loss cannot be wholly set-off under section 34, so much of the loss as has not been set-off, or the whole of the loss where the assessee has no income under any other head, shall be carried forward, subject to clause (v) of sub-section (1) of section 23, to the following assessment year and set-off against the profits and*

gains, if any, of such business or profession assessable for that year if such business or profession continues to be carried on by the assessee for that assessment year; and if the loss cannot be wholly set-off in this manner, the amount of the loss not so set-off shall be carried forward to the following assessment year, and so on, but no loss shall be carried forward to more than six assessment years immediately succeeding the assessment year for which the loss was first computed:

Provided that...”

Thus the conditions of the right to carry forward business losses for the purposes of set-off are as follows:-

- (i) The loss should fall under the head 'income from business or profession' defined in Section 22 of the Ordinance;
- (ii) It should not be a loss to which Section 36 of the Ordinance applies, i.e. speculation losses;
- (iii) The loss shall be carried forward to the following assessment year and set-off against the profits and gains of such business or profession assessable for that year. In other words, the loss being carried forward cannot be set-off against a source other than the profits and gains of such business or profession;
- (iv) The business or profession in which the loss was originally sustained should continue to be carried on by the assessee for the assessment year in which carried forward loss is sought to be set-off;
- (v) A loss cannot be carried forward for more than six years from the assessment year for which the loss was first computed;
- (vi) A loss cannot be carried forward unless it has been determined in pursuance of a return filed under Section 55

of the Ordinance. In order to be entitled to carry forward a loss, the assessee must submit a return under Section 55 *ibid* and have an assessment made for the year in which he has incurred the loss. The Assessing Officer has to notify to the assessee by an order in writing the amount of the loss as computed by him which the assessee is entitled to have carried forward.

Therefore under the Ordinance, losses of assesseees can be carried forward and subsequently set-off according to the provisions of Section 35 of the Ordinance. No exception has been created vis-à-vis tax holidays, whereby such periods have been excluded for the purposes of carrying forward and setting off of losses. While it is clear, upon a perusal of the Ordinance, that it does not preclude losses incurred during tax holidays from being carried forward and set-off subsequently as per Section 35 thereof, nevertheless if the interpretation adopted by the learned counsel for the appellant/department was also possible, or there existed an ambiguity, in such a situation an interpretation favourable to the tax payer should be preferred as settled by this Court in **Pakistan through Secretary Finance and others Vs. Messrs Lucky Cement and another (2007 SCMR 1367)**. Regarding the case of **Iqbal Engineering Works** (*supra*) relied upon by the learned counsel for the appellants, it involved an interpretation of Section 24 of the Income Tax Act, 1922 and the issue was regarding set-off of losses in the context of a registered firm and therefore is not relevant to the instant matter.

Therefore, in our candid view, the respondents/industrial undertakings were entitled to carrying forward and setting off of the losses they incurred during the tax holiday period in accordance with the provisions of Section 35 of the Ordinance. In light whereof, Civil Appeals No.1264 to 1270/2006, 975/2007, 229/2010, 722 and

723/2011 and 697/2015 are dismissed. Regarding Civil Appeal No.1574/2007 dismissed for non-prosecution vide order dated 27.2.2008, for the reasons stated in C.M.A.No.793/2008, the same is allowed and the main appeal (C.A.No.1574/2007) is restored to its original number and is dismissed for the reasons enumerated above.

7. As regards Civil Appeals No.716 and 717/2011, the issue involved therein is regarding carrying forward of unabsorbed depreciation allowance. Section 38(6) of the Ordinance provides that:-

*“Where, in making an assessment for any year, full effect cannot be given to the allowances referred to in clause (v) of sub-section (1) of section 23 owing to there being no profits or gains chargeable for that year or such profits or gains being less than the allowance, then, subject to clause (v) of sub-section (1) of section 23 and the provisions of sub-section (7), **the allowance or part of the allowance to which effect has not been given**, as the case may be, shall be added to the amount of the allowance for depreciation for the following year and be deemed to be part of that allowance, or if there is no such allowance for that year, be deemed to be the allowance for that year and so on for succeeding years.”*

(Emphasis supplied)

While Section 38(6) of the Ordinance allows for carrying forward of unabsorbed depreciation allowance, an exception has been provided under Rule 3A of the Third Schedule of the Ordinance which (*rule*) reads as under:-

*“(3A) Where any building, furniture, machinery or plant is used for the purposes of business or profession during any income year for which the **income from***

such business or profession is exempt from tax, depreciation admissible under sub-rule (1) shall be deemed to have been allowed in respect of the said income year and after expiration of the exemption period written down value of such assets shall be determined in accordance with sub-clause (ii) of clause (b) of sub-rule (7) of rule 8.”

(Emphasis supplied)

Rule 3A *ibid* provides for depreciation allowance to be **deemed** to have been allowed, which in turn means that it has been given **due effect** for the purposes of Section 38(6) of the Ordinance and therefore cannot be carried forward to subsequent assessment years. Unlike the case with carrying forward of losses under Section 35 of the Ordinance, there exists a clear exception in the form of Rule 3A of the Third Schedule to carrying forward of unabsorbed depreciation allowances under Section 38(6) of the Ordinance. In the case of **Anwar Textile Mills** (*supra*) relied upon by the learned counsel for the appellants, the question that arose before the learned High Court of Sindh was whether the assessee was entitled to carry forward the unabsorbed amount of depreciation after the expiry of the tax holiday period and the Court held that the right to carry forward unabsorbed depreciation to the following year was conferred by proviso (b) of Section 10(2)(vi) of the Income Tax Act, 1922 and the applicability of such provision was not excluded, therefore the assessee was allowed to carry forward the unabsorbed depreciation amount. However, in the instant matter, as mentioned above, undoubtedly an exception has been provided to carry forward unabsorbed depreciation allowance by virtue of Rule 3A of the Third Schedule to the Ordinance.

Therefore, we opine that the respondent/industrial undertaking (in Civil Appeals No.716 and 717/2011) is not entitled to carry forward to the post-tax holiday period, the unabsorbed depreciation allowances that arose during the tax holiday period. In light whereof, Civil Appeals No.716 and 717/2011 are allowed and the impugned judgments are set aside.

JUDGE

JUDGE

JUDGE

Announced in open Court
on 25.11.2016 at Islamabad
Approved For Reporting
Ghulam Raza/*