

IN THE SUPREME COURT OF PAKISTAN
(APPELLATE JURISDICTION)

PRESENT:

MR. JUSTICE EJAZ AFZAL KHAN
MR. JUSTICE MAQBOOL BAQAR
MR. JUSTICE FAISAL ARAB

CIVIL APPEAL NO. 27 OF 2009

(On appeal against the judgment dated
09.10.2008 passed by the High Court of
Sindh, Karachi in ITRA No. 186/2007)

Commissioner of Income Tax, Large Taxpayers Unit, Karachi

... Appellant

VERSUS

International Power Global Developments Limited, Karachi

... Respondent

For the Appellant: Dr. Farhat Zafar, ASC
Raja Abdul Ghafoor, AOR

For the Respondent: Mr. Muhammad Idris, ASC

Date of Hearing: 21.02.2018

JUDGMENT

FAISAL ARAB, J.- The appellant has called in question the decision of the High Court of Sindh rendered in an Income Tax Reference Appeal (ITRA No.186 of 2007). The subject matter of this appeal is the question of law that was decided against the department and in favour of the respondent, same is reproduced as follows:-

"Whether on the facts and circumstance of the case the Hon'ble Tribunal was not justified in disallowing deduction on the applicant's business expenditure the expenses incurred by the applicant on events of sports and social activities organized for the benefit of the applicant personnel and members of their family."

2. The facts of the case are that respondent derives its income by rendering operational and maintenance service to the Hub-Power Company Limited. In the assessment year 2001-2002 the respondent incurred an expenditure of Rs.1,200,000/- for setting up a sports and recreational facility for its employees who reside within its residential colony. The respondent deducted this expense while computing its income. The Tax department while passing the assessment order disallowed such deduction, which was challenged without success upto the stage of Income Tax Appellate Tribunal. The respondent then challenged the decision of the tribunal in the High Court of Sindh, which answered the question of law in the affirmative in favour of the respondent and against the tax department vide judgment dated 09.10.2008, hence this appeal with the leave of this Court.

3. Section 15 of the Income Tax Ordinance, 1979 classifies various heads of income, which includes 'income from business and profession'. Section 22 of the said Ordinance describes various sources of income that are chargeable to tax under the head 'income from business and profession' and respondent's business falls under Section 22. Section 23 describes various allowances and other deductibles that can be deducted while computing the income derived from business or profession falling within the ambit of Section 22. Such deductibles include, any rent paid for the premises in which such business or profession is carried on; any amount paid for repairs on the premises or any other machinery, plant, furniture or fittings used

for the purpose of business; any premium paid in respect of insurance against risk of damage or destruction to any building, machinery, plant, furniture or fittings, or stocks and stores used for the purposes of business or profession; depreciation expense; any expenditure (not being in the nature of capital expenditure or personal expenses of the assessee) laid out or expended wholly and exclusively for the purpose of such business or profession. Section 23(xviii) of the 1979 Ordinance is more significant to examine the controversy in hand. It states *"any expenditure (not being in the nature of capital expenditure or personal expenses of the assessee) laid out or expended wholly and exclusively for the purpose of such business or profession"* shall be made in computing income.

4. A plain reading of Section 23 of the 1979 Ordinance shows that it specifically spells out in minute detail the types of allowances or deductions that can be made in computing the income under the head "Income from business or profession", which means that any allowance or expenditure that falls outside the pale of Section 23 has to be treated as not deductible from the income. In other words, only such allowances and deductions are permissible which in some manner have nexus with the income that is derived from a business or profession.

5. Learned counsel for the respondent in support of the reasoning given in the impugned judgment has heavily relied upon the provision of Section 23(xviii) of the 1979 Ordinance. The only question that needs to be answered in the present case, therefore, is whether the expense of Rs.1,200,000/- incurred by the

respondent in providing a facility for sports and social activities for its employees can be deducted while computing income on the strength of the provisions of Section 23(xviii). Undeniably the expense in question is not a part of the salary or perk or privilege which the respondent pays to its employees under the contractual obligations for rendering service. It was simply incurred to setup a complimentary facility for the employees which has no direct nexus with the generation of the respondent's income derived from rendering operational and maintenance services to the Hub-Power Company Limited. Hence, on the face of it, the expense in dispute neither falls under Section 23(xviii) of the 1979 Ordinance nor any other category of allowances or deductibles listed in rest of the provisions of Section 23, so as to justify its deduction while computing respondent's income. The High Court of Sindh allowed its adjustment simply on the ground that sports and social activities boost mental and physical health of a person by answering the question of law in the affirmative. This may be so but that *ipso facto* cannot be regarded as a type of allowance that can be directly co-related to any category of allowances and deductibles listed in Section 23 of the 1979 Ordinance with the business activity of the respondent, which is rendering of operational and maintenance services to a power generating company. The conclusion of the High Court being totally misconceived and not based on any provision of Section 23 is not sustainable in law. The expenditure in question, therefore, cannot be taken into consideration while computing business income of the respondent.

6. For what has been discussed above, this appeal is allowed, the impugned judgment is set aside and the decision of the Tribunal is restored.

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Islamabad, the
21st of February, 2018
Approved For Reporting
Khurram

“22. **Income from business or profession.**- The following incomes shall be chargeable under the head "Income from business or profession", namely:-

- (a) profits and gains of any business or profession carried on, or deemed to be carried on, by the assessee at any time during the income year;
- (b) income derived by any trade, professional and similar association from specific services performed for its members; and
- (c) value of any benefit or perquisite, whether convertible in to money or not, arising from business or the exercise of a profession.

Explanation.- Where speculative transactions carried on by an assessee are of such a nature as to constitute a business, the business (hereinafter referred to as “speculation business”) shall be deemed to be distinct and separate from any other business carried on by the assessee.

“23. **Deductions.**- (1) In computing the income under the head "Income from business or profession", the following allowances and deductions shall be made, namely:-

- (i) any rent paid for the premises in which such business or profession is carried on;
- (ii) any local rate, tax, charge or cess in respect of such premises paid to any local authority or Government, not being any tax payable under this Ordinance;
- (iii) any amount paid on account of current repairs to any such premises or any machinery, plant, furniture or fittings used for purposes of business or profession;
- (iv) any premium paid in respect of insurance against risk of damage or destruction to any building, machinery, plant, furniture or fittings, or stocks and stores used for the purposes of business or profession;
- (v) in respect of depreciation [including First Year Allowance or Reinvestment Allowance or Industrial Building Allowance,] of any such building, machinery, plant, furniture or fittings, being the property of the assessee, the allowance admissible under the Third Schedule, [except depreciation on assets given on lease shall be allowed against income from lease rentals only];
- (vi) in respect of animals which have been used for the purposes of the business or profession (otherwise than as stock-in-trade) and have died or become permanently useless for such purposes, the difference between the original cost to the assessee of the animals and the amount, if any, realised in respect of the carcasses or animals;
- [(via) any sum paid on or after the first day of July, 1985, to a schedule bank, a financial institution, or such modaraba or leasing company as is approved by the Central Board of Revenue for the purposes of the Third Schedule, by way of lease money in respect of an asset taken on lease by the

assessee and used for the purposes of any business or profession carried on by him;]

- (vii) any interest paid in respect of capital borrowed for the purposes of the business or profession;
- [(viiia) any sum paid to a modaraba or to a Participation Term Certificate holder for any funds borrowed for the purposes of the business or profession;]
- [(viiib) any sum paid or credited to any person maintaining a profit and loss sharing account or deposit with a scheduled bank by way of distribution of profits by the said bank in respect of the said account or deposit;]
- [(viiic) any sum paid by the House Building Finance Corporation constituted under the House Building Finance Corporation Act, 1952 (XVIII of 1952), to the State Bank of Pakistan (hereinafter referred to as the 'Bank') as the share of the Bank in the profits earned by the said Corporation on its investment in the property made under a Scheme of investment in property on partnership in profit and loss, where such investment is provided by the Bank under the House Building Finance Corporation (Issue and Redemption of Certificates) Regulations, 1982;]
- [(viiicc) any sum paid by the National Development Leasing Corporation Limited to the State Bank of Pakistan (hereinafter referred to as the 'Bank') as the share of the Bank in the profits earned by the said Corporation on its leasing operations financed out of a credit line provided by the Bank on a profit and loss sharing basis;]
- [(viiid) any sum paid to a bank under a scheme of musharika representing its share in the profits of that Musharika;]
- [(viiie) any sum paid to a certificate holder under a Musharika scheme approved by the Corporate Law Authority and Religious Board formed under the Modaraba Companies and Modarabas (Floatation and Control) Ordinance, 1980 (XXXI of 1980) representing his in the profits of that Musharika,;
- (viii) any sum paid to an employee as bonus or commission for services rendered, where such sum would not have been payable to him as profits or dividend if it had not been paid as bonus or commission:

Provided that the amount of the bonus or commission is of a reasonable amount with reference to-

- (a) the pay of the employee and the conditions of his service;
- (b) the profits of the business or profession for the year in question; and
- (c) the general practice in similar businesses or professions;

- (ix) in respect of any special reserve created by such financial institutions and for such purposes as may be approved by the Central Board of Revenue for the purposes of this clause, the amount, not exceeding ten percent of the total income including such amount, carried to such reserve.

Provided that no allowance under this clause shall be made where the aggregate amount standing in such reserve exceeds the paid-up capital of the institution.

- (x) in respect of bad debts, such amount (not exceeding the amount actually written off by the assessee) as may be determined by the [Deputy Commissioner] to be irrecoverable;
- (xi) any sum paid to a scientific research institute, polytechnic, college or other institution in Pakistan affiliated to any University or Board of Education established or incorporated by, or under, any Federal or Provincial law, or recognised, aided or run by Government or run by any local authority, to be used for scientific research or technical training in Pakistan; []
- (xii) any expenditure laid out or expended on scientific research in Pakistan related to the business carried on by the assessee;
- (xiii) any expenditure laid out or expended on any educational institution or hospital in Pakistan established for the benefit of the employees, their families and dependants;
- (xiv) any expenditure laid out or expended on any institute in Pakistan established for the training of industrial workers recognised, aided or run by Government or run by any local authority;
- (xv) any expenditure laid out or expended on the training of any person, being a citizen of Pakistan, in connection with a scheme approved by the Central Board of Revenue for the purposes of this clause;
- (xvi) any sums paid on account of annual membership subscription to a registered trade organisation within the meaning of the Trade Organisations Ordinance, 1961 (XLV of 1961);
- (xvii) any expenditure incurred by an assessee wholly and exclusively in connection with his visit abroad as a member of a trade delegation sponsored by the Federal Government;
- (xviii) any expenditure (not being in the nature of capital expenditure or personal expenses of the assessee) laid out or expended wholly and exclusively for the purpose of such business or profession;

[Provided that, where a domestic company has, in any income year, incurred any expenditure on advertisement or publicity outside Pakistan in respect of such goods as may be specified by the Federal Government by notification in the official Gazette and as are exported in the said income year, or on furnishing of samples of such

goods to a person outside Pakistan, deduction in respect of the said expenditure allowable under this clause shall be of a sum equal to one and one-third times the amount of actual expenditure so incurred.]

- [(xix) any transfer to a participatory reserve created by a company under section 120 of the Companies Ordinance, 1984 (XLVII of 1984), in accordance with an agreement relating to participatory redeemable capital entered into between the company and a banking company as defined in the Banking Tribunals Ordinance, 1984:

Provided that, out of the amount so transferred in any income year, not more than five percent of the value of participatory redeemable capital shall qualify for deduction under this sub-section:

Provided further that no deduction shall be allowed if the amount of the tax-exempted accumulation in the participatory reserve exceeds 10 percent of the amount of participatory redeemable capital;

- [(xx) any expenditure incurred by an assessee in the purchase of one machine, with permanent sealed memory system, used for recording and printing cash sales made by him during the regular course of his business:

Explanation.-

- (a) the expression "any expenditure", as used in clauses (xii), (xiii) and (xiv), includes expenditure in the nature of capital expenditure; and
 - (b) the expression "paid", as used in this section and sections 18, 24 and 31, means actually paid or incurred according to the method of accounting upon the basis of which the income is computed.
- (2) Where any such premises, building, machinery, plant, furniture or fittings is or are not wholly used for the purposes of the business or profession, any allowance or deduction admissible under this section shall be restricted to the fair proportional part of the amount which would be allowable if such premises, building, machinery, plant, furniture or fittings were wholly so used.

For the convenience sake, Section 23 is referred as follows:-

"23. Deductions.- (1) *In computing the income under the head "Income from business or profession", the following allowances and deductions shall be made, namely:-*

- (i) *any rent paid for the premises in which such business or profession is carried on;*
- (ii) *any local rate, tax, charge or cess in respect of such premises paid to any local authority or Government, not being any tax payable under this Ordinance;*
- (iii) *any amount paid on account of current repairs to any such premises or any machinery, plant, furniture or fittings used for purposes of business or profession;*
- (iv) *any premium paid in respect of insurance against risk of damage or destruction to any building, machinery, plant, furniture or fittings, or stocks and stores used for the purposes of business or profession;*
- (v) *in respect of depreciation [including First Year Allowance or Reinvestment Allowance or Industrial Building Allowance,] of any such building, machinery, plant, furniture or fittings, being the property of the assessee, the allowance admissible under the Third Schedule, [except depreciation on assets given on lease shall be allowed against income from lease rentals only];*
- (vi) *in respect of animals which have been used for the purposes of the business or profession (otherwise than as stock-in-trade) and have died or become permanently useless for such purposes, the difference between the original cost to the assessee of the animals and the amount, if any, realised in respect of the carcasses or animals;*
- (via) *any sum paid on or after the first day of July, 1985, to a schedule bank, a financial institution, or such modaraba or leasing company as is approved by the Central Board of Revenue for the purposes of the Third Schedule, by way of lease money in respect of an asset taken on lease by the assessee and used for the purposes of any business or profession carried on by him;]*
- (vii) *any interest paid in respect of capital borrowed for the purposes of the business or profession;*
- (viiia) *any sum paid to a modaraba or to a Participation Term Certificate holder for any funds borrowed for the purposes of the business or profession;]*
- (viiib) *any sum paid or credited to any person maintaining a profit and loss sharing account or deposit with a scheduled bank by way of distribution of profits by the said bank in respect of the said account or deposit;]*
- (viiic) *any sum paid by the House Building Finance Corporation constituted under the House Building Finance Corporation Act, 1952 (XVIII of 1952), to the State Bank of Pakistan (hereinafter referred to as the 'Bank') as the share of the*

Bank in the profits earned by the said Corporation on its investment in the property made under a Scheme of investment in property on partnership in profit and loss, where such investment is provided by the Bank under the House Building Finance Corporation (Issue and Redemption of Certificates) Regulations, 1982;]

- (viicc) any sum paid by the National Development Leasing Corporation Limited to the State Bank of Pakistan (hereinafter referred to as the 'Bank') as the share of the Bank in the profits earned by the said Corporation on its leasing operations financed out of a credit line provided by the Bank on a profit and loss sharing basis;]*
- (viid) any sum paid to a bank under a scheme of musharika representing its share in the profits of that Musharika;]*
- (viie) any sum paid to a certificate holder under a Musharika scheme approved by the Corporate Law Authority and Religious Board formed under the Modaraba Companies and Modarabas (Floatation and Control) Ordinance, 1980 (XXXI of 1980) representing his in the profits of that Musharika,:*
- (viii) any sum paid to an employee as bonus or commission for services rendered, where such sum would not have been payable to him as profits or dividend if it had not been paid as bonus or commission:*

Provided that the amount of the bonus or commission is of a reasonable amount with reference to-

- (a) the pay of the employee and the conditions of his service;*
 - (b) the profits of the business or profession for the year in question; and*
 - (c) the general practice in similar businesses or professions;*
 - (ix) in respect of any special reserve created by such financial institutions and for such purposes as may be approved by the Central Board of Revenue for the purposes of this clause, the amount, not exceeding ten percent of the total income including such amount, carried to such reserve.*
- Provided that no allowance under this clause shall be made where the aggregate amount standing in such reserve exceeds the paid-up capital of the institution.*
- (x) in respect of bad debts, such amount (not exceeding the amount actually written off by the assessee) as may be determined by the Deputy Commissioner to be irrecoverable;*
 - (xi) any sum paid to a scientific research institute, polytechnic, college or other institution in Pakistan affiliated to any University or Board of Education established or incorporated by, or under, any Federal or Provincial law, or recognised, aided or run by Government or run by any local authority, to be used for scientific research or technical training in Pakistan;*

- (xii) *any expenditure laid out or expended on scientific research in Pakistan related to the business carried on by the assessee;*
- (xiii) *any expenditure laid out or expended on any educational institution or hospital in Pakistan established for the benefit of the employees, their families and dependants;*
- (xiv) *any expenditure laid out or expended on any institute in Pakistan established for the training of industrial workers recognised, aided or run by Government or run by any local authority;*
- (xv) *any expenditure laid out or expended on the training of any person, being a citizen of Pakistan, in connection with a scheme approved by the Central Board of Revenue for the purposes of this clause;*
- (xvi) *any sums paid on account of annual membership subscription to a registered trade organisation within the meaning of the Trade Organisations Ordinance, 1961 (XLV of 1961);*
- (xvii) *any expenditure incurred by an assessee wholly and exclusively in connection with his visit abroad as a member of a trade delegation sponsored by the Federal Government;*
- (xviii) *any expenditure (not being in the nature of capital expenditure or personal expenses of the assessee) laid out or expended wholly and exclusively for the purpose of such business or profession;*

[Provided that, where a domestic company has, in any income year, incurred any expenditure on advertisement or publicity outside Pakistan in respect of such goods as may be specified by the Federal Government by notification in the official Gazette and as are exported in the said income year, or on furnishing of samples of such goods to a person outside Pakistan, deduction in respect of the said expenditure allowable under this clause shall be of a sum equal to one and one-third times the amount of actual expenditure so incurred.]

- (xix) *any transfer to a participatory reserve created by a company under section 120 of the Companies Ordinance, 1984 (XLVII of 1984), in accordance with an agreement relating to participatory redeemable capital entered into between the company and a banking company as defined in the Banking Tribunals Ordinance, 1984:*

Provided that, out of the amount so transferred in any income year, not more than five percent of the value of participatory redeemable capital shall qualify for deduction under this sub-section:

Provided further that no deduction shall be allowed if the amount of the tax-exempted accumulation in the participatory reserve exceeds 10 percent of the amount of participatory redeemable capital;

- (xx) *any expenditure incurred by an assessee in the purchase of one machine, with permanent sealed memory system, used for recording and printing cash sales made by him during the regular course of his business:*

Explanation. -

- (a) *the expression "any expenditure", as used in clauses (xii), (xiii) and (xiv), includes expenditure in the nature of capital expenditure; and*
- (b) *the expression "paid", as used in this section and sections 18, 24 and 31, means actually paid or incurred according to the method of accounting upon the basis of which the income is computed.*
- (2) *Where any such premises, building, machinery, plant, furniture or fittings is or are not wholly used for the purposes of the business or profession, any allowance or deduction admissible under this section shall be restricted to the fair proportional part of the amount which would be allowable if such premises, building, machinery, plant, furniture or fittings were wholly so used."*