JUDGMENT SHEET.

IN THE ISLAMABAD HIGH COURT, ISLAMABAD.

Income Tax Reference No.219 of 2011

Commissioner Inland Revenue (Zone-I), Large Taxpayers Unit, Islamabad.

Versus

M/s Agricultural Development Bank of Pakistan

Applicant's by	:	**Dr. Farhat Zafar, Advocate.**
Respondent's by	:	**Mr. Muhammad Abu Bakar & Mr. Iqbal Hashmi, Advocates**
Date of decision	:	**04.03.2020.**

LUBNA SALEEM PERVEZ, J. Through present reference application u/s 133(1) of the Income Tax Ordinance, 2001, *(hereinafter referred to "the Ordinance, 2001"),* applicant department has assailed the (consolidated) order dated 01.03.2011, passed by the learned Appellate Tribunal Inland Revenue, Islamabad, *(hereinafter referred to "the ATIR")* in ITA No. 06/IB/2011, relating to assessment year 2002-03, whereby, the addition of post-retirement medical benefits at 50% of the claim as restricted by ATIR and deletion of addition made against non-performing loans was confirmed.

2. Brief facts of the case are that the Respondent a banking company derives income from lending money to the Agriculturist and from other receipts filed Income tax return for the assessment year 2002-03 by declaring loss of Rs. 2,444,778,030/-. Record reveals that in the first round the assessment order passed u/s 62 of the Income Tax Ordinance, 1979, was challenged before appellate foras and the ITAT (now the ATIR),vide order dated 18.10.2007, remanded back the issues relating to the additions under the head "provision for employees post-retirement medical fund", "provision for employees compensated absence" and "provisions for non-performing loans" to the Assessing Officer for fresh assessment after reconsideration of the record. The Assessing Officer, however, allowed the provision for employees compensated absences but again disallowed the "provision for non-performing loans" and "provision for post-retirement

medical fund"and added the same to the income of the Respondent, thereby assessing income at Rs. 3,401,554,970/- vide Order u/s 135 of the Ordinance, 2001, dated 30.06.2009.

3. Against the above order, the Respondent filed appeal before the Commissioner Inland Revenue Appeals-II, Islamabad *(hereinafter referred to as the "CIRA")* who vide order No. 53C/2010 dated 20.10.2010, restricted the addition made on account of employee post-retirement medical fund to the extent of 50% of the claim in terms of decision of the ITATvide Order Nos.706 & 707/IB/2003, 969/IB/2004 & 186/IB/2007 dated 18.10.2007.The finding of the CIRA is as under:-

> "***Postretirement Medical benefit:***
> *Regarding provision of employees postretirement medical benefit the learned ITAT in the case of the appellant vide order No.706 and 707/IB/2003, 969/IB/2004 & 186/IB/2007 dated 18.10.2007, has already directed to allow 50% claim on account of post-retirement medical benefits, accordingly I direct the same treatment in this year also.".*

The CIRAin respect of general "provisions for non-performing loans" confirmed the treatment meted out by the Assessing Officer and observed as under:-

> ***"Provision of non-performing loans:***
> *In this regard I have examined the treatment of Taxation officer whereby the taxpayer has not being able to establish that the general provision for nonperforming loans at Rs. 3,000,000,000/- was in the nature of provision of in respect of nonperforming use, I endorse the findings of Taxation Officer. The order of the taxation officer on this account is confirmed.".*

4. The applicant department as well as the Respondent challenged the said order by filing appeals before the ATIR, who vide its order dated 01.03.2011, passed in ITA No. 06/IB/2011 (departmental appeal) and ITA No.965/IB/2010 (taxpayer/respondent's appeal), maintained the above finding of the CIRA for disallowing 50% of the claim of "provision for employees post-retirement medical benefits" in the following words:-

> *"We have heard arguments and counter arguments of both the parties and have also perused the available record. It is observed that this Tribunal in Tax Year 2003 and 2004 in the case of the appellant has allowed 50% post-retirement medical benefits to the appellant so the issue has already been settled by the Tribunal. We, therefore, do not have any hesitation in maintaining the order of the CIR (A)".*

While for deletion of addition of general provisions for non-performing loans disallowed by the Assessing officer,the ATIR relied on its earlier

decision and on the judgment of the Hon'ble Sindh High Court in ITRA No. 219 of 2008. The relevant findings of the ATIR are as under:-

> *"In any case after the recent judgment of Honorable High Court Sindh in ITRA No.219 of 2008 recorded by Mr. Justice Athar Saeed, which is in continuation of many earlier judgments on the issue including in the case of National Bank of Pakistan reported as (1976) 34 Tax 158 (H.C. Kar), there is no further discussion required. We, therefore, conclude the discussion by reproducing the relevant para there from. The same reads as follows:-*
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> > *"After reading the above extract from the judgment and the judgment of this Court in the case of National Bank of Pakistan and the instruction of CBR reproduced above, we are satisfied that the bad debt had been properly written off in accordance with the provisions of section 29. We will, therefore, answer Question Nos. 1 & 2 in affirmative in favour of the Respondent and against the Appellant."*
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> *Above findings confirms the decision of this Tribunal recorded in a chain of judgments.*
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> *In view of the discussion, no further dilation will be required. Since it is not in dispute that the amount under consideration has been shown following of the rules applicable, the addition is unlawful and the same is deleted".*

Being dissatisfied with the above finding the applicant department filed present reference application u/s 133(1) of the Income Tax Ordinance, 2001 against the ITA No. 06/IB/11, relating to assessment year 2002-03 and referred following questions of law said to arise out of the said order:-

Questions of Law:-

i. *Whether in the facts and circumstances of the case the learned Appellate Tribunal Inland Revenue was justified to restrict the disallowance against the addition on account of provision for Employees Post-Retirement Medical Benefits to the extent of 50% while the taxpayer failed to substantiate its claim before Taxation Officer as well as ATIR?*

ii. *Whether in the facts and circumstances of the case the learned Appellate Tribunal Inland Revenue was justified to delete the addition on account of general provision of non-performing loans amounting to Rs.3 billion, when all the efforts for its recovery had not been made under the law?*

5. Learned counsel for the applicant supported the Order passed by the Assessing Officer and submitted that the ATIR was not justified in restricting the addition to the extent of 50% of the provision for employees

post-retirement medical benefits claimed as allowable expense by the Respondent, as under the Income Tax Ordinance, 2001 the expenses are allowed in the year when it is actually incurred. Regarding allowing of non-performing loans by the ATIR she stated that the Respondent could not substantiate the claim before assessing officer on the basis of record produced during reassessment proceedings and in view thereof, she submitted that the findingsis not sustainable in law.

6. The learned counsel for the Respondent argued that the CIRA and the ATIR have restricted the additions at 50% of the claim of the provision for employee post-retirement medical benefits by relying on its earlier decision being binding on the ATIR as well as on CIRA and submitted that the provision is based on Acturial valuation thus is an ascertained liability duly allowable expense under the law. Learned counsel on deletion of addition of non-performing loans argued that as per directions of the ITAT, during the reassessment proceedings each and every document regarding the claim was provided to the Assessing Officer however, the Assessing Officer rejected all the documents/details and disallowed the claim and added the same amount to the income of the Respondent while passing reassessing order. He submitted that both the claimed expenses have been, rightly allowed by the CIRA and ATIR.

7. Arguments heard and record perused with the able assistance of the learned counsel for the parties.

8. Perusal of the record and order shows that the benefits of post-retirement medical facilities, was granted to the employees and their families by the Respondent. For this purpose, the Respondent on the basis of actuarial valuation report allocated the amount by making provision in the accounts and deducted the provision as an expense while computing the taxable income considering it to an ascertained liability for the year. The Assessing Officer disallowed the provision for post-retirement medical benefits on the ground that the Respondent could not provide legal provision or any judgment of the indigenous courts.

9. The Income Tax Ordinance, 2001 provides for computation of income from business by three methods of accounting (i) cash system of

accounting; (ii) the hybrid system of accounting and (iii) the accrual/mercantile system of accounting. According to section 32(2) of the Income Tax Ordinance, 2001, it is mandatory on the companies to account for the income chargeable to tax under the head income from business on accrual system of accounting. Section 34(1) explains the accrual basis accounting as under:

> *Section 34: (1) A person accounting for income chargeable to tax under the head "Income from Business" on an accrual basis shall derive income when it is due to the person and shall incur expenditure when it is payable by the person.*

Thus, in this method of accounting the transactions of income and expenses are recognized in the accounts as and when they occurred regardless of the payments to be made in future. The Respondent being a company under section 32 of the Ordinance required to adopt accrual system of accounting, therefore, as per section 34 read with accounting standards the provision made for post-retirement benefit, on the basis of actuarial valuation is a determined liability payable in future in terms of section 34(3) of the Income Tax Ordinance, 2001; hence, is an allowable expenditure to the Respondent in the year it is accrued as a liability. This Court in the case titled as ***"CIT (Legal), Islamabad vs. Askari Commercial bank" (2018 PTD 1089)*** while deliberating on the method of accounting in respect of the banking companies, has held as under:-

> *"The distinction between accounting on cash basis or accrual basis is explained under section 33 & 34 respectively which is in consonance with the method of accounting which are recognized under the International accounting standards. The legislature by inserting section 100 (A) and seventh schedule through Finance, Act 2007 inter alia, has provided that income profits and gains of a banking company shall be taken to be the balance of the income from all sources before tax disclosed in the annual accounts which are required to be furnished to the State Bank of Pakistan"*

In the same judgment the Hon'ble Court has reiterated the settled law of interpretation of fiscal statute as under:-

> *"It is the settled law of interpretation of statute that provisions are required to be read in its context. In the case taxing statute the Courts has to look to the clear words since there is no question of any intendment, nor thereisany presumption or equity about tax. Nothing can be read or implied in the taxing statute. It is also a settled rule of interpretation that in order to discover the legislative intent the statute has to be read as a whole.*

It would not be out of place to refer the judgment of Hon'ble Sindh High Court titled as ***"Commissioner Legal Division vs. Civil Aviation Authority" (2008 PTD 647)***, wherein, the provision of section 10(2)(v) of the Income Tax Act, 1922, has been interpreted with reference to entitlement of deduction of expense in the mercantile system of accounting. The relevant portion is reproduced as under:-

> *"6. The perusal of the judgment of Sindh High Court relied by Tribunal also relates to Income Tax Act, 1922 but in this case this Court has analyzed section 10(2)(x) in the light of section 10(2)(v) which is as under:-*
>
> *Section 10(2)(v)....In subsection "(2)" paid means actually paid or incurred according to the method of accounting upon the basis of which the profits or gains are computed under this section"*
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> *7. On the basis of interpretation of this section, the Court has held that if the taxpayer followed the mercantile basis of accounting then he was entitled to the deduction of bonus provided during the yeardespite the fact that it was not paid during the year. We have also examined the judgment of Honourable Apex Court reported in the case of Commissioner of Income Tax Vs Oriental Dyes and Chemical Company Ltd, reported in 1992 SCMR 763 in which the Honorable Apex Court has held that provision for gratuity being an ascertain liability is an allowable expense even though not actually paid during the year.".*

10. Taking guidance from the judgments cited above and considering the relevant law, we are of the opinion that it is mandatory for the banking companies to maintain their accounts on accrual based accounting system; therefore, the provision of ascertained liability is also an allowable expense even though same are not actually paid during the year.

11. While examining the record to discuss the issue of deletion of non-performing loans by the ATIR, it is observed that in the first round of appeal both the above issues were remanded back by the ITAT for reassessment after reconsideration of the record and relevant documents. The previous proceedings i.e. order u/s 62 and the appellate orders of Commissioner Appeals and ITAT, were not made part of the present ITR. However, the observation of the ITAT while remanding the issue in respect of non-performing loans have been reproduced in the order passed by the CIRA dated 20.10.2010, which being pertinent is also reproduced below:-

> *"In these conditions onus lies on the assesse-bank to prove that the amount in question was in the nature of provision in respect*

of non-performing loans and if it can successfully establish its claim with the help of accounts and documents, then it will be entitled to deduction from its income on this score. We, therefore, hold that learned CIT(A) has rightly set aside the assessment on this issue ***for re-examination in the light of relevant records****. We do not find any reason to interfere with the orders of learned CIT(A) which are hereby maintained andit is directed that during the course of re-assessment proceedings this issue should be minutely examined with the help of relevant documents and records and if it is established to the satisfaction of the assessing officer that* ***the amount in question is primarily in the nature of provision in respect of non-performing loans, the same should be allowed as a deduction from income.****".*

12. From the above observation of the Appellate Tribunal we found that principally the issue of allowability of the "provision for non-performing loans"was accepted by ITAT, however, it was remanded back for examination of the relevant documents supporting the claim. Perusal of the re-assessment order dated 30.06.2009, reveals that in response to notice, the Respondent had provided the necessary documents and record pertaining to general provision for non-performing loans amounting to Rs.3.00 billion but the Assessing Officer rejected all the documents with a view that documents produced are not sufficient for allowing of the claim. The treatment of the Assessing Officer was confirmed by Commissioner Appeals vide order dated 20.10.2010. However the ATIR allowed the claim vide impugned order on the following reasoning:-

"In fact the issue of allowance or disallowance of bad debts had now taken rest. If the same is seen from the angle of the findings of this Tribunal as well as of the Honourable High Court, there is a chain of judgments in which this Court has observed that write off of the bad debts by a bank is of more loss to it than the gain in the terms of reduction in revenue. If the claim of the bad debt in the accounts is following the Prudential Banking regulations of the State Bank of Pakistan becomes allowable and can only be disallowed if the State Bank of Pakistan has objected to the said claim. The reason being obvious, it is the government of Pakistan through its monitory agency State Bank of Pakistan, which controls such transaction in order to protect the interest of the accounts holders and all others concerned. In the preset case, the situation is more obvious than in the cases of the private banks. It is a government controlled bank in which all the employees are government servants. This bank is not only subject to audit by internal or external auditors but is transactions are also checked by other controlling agencies and are subject to watch of the Public Accounts committee (PAC) as well. Each and every transaction shown in its accounts is subject to check of the people, public, public representatives as well as various agencies of the government of Pakistan. The judgments of this court as well as of the other courts, which are mostly in the cases of the banks with a much stronger power. The check on the accounts of Zarai Taraqiati Bank is obviously more exhaustive than of the other banks. In these circumstances the amount which is being

written off cannot be assumed to be as in deviation of the State Bank's law and rules. This Court has given its findings in favour of the taxpayer in dozens of the cases including (2006) 94 Tax 130 (Trib.)".

Perusal of the above finding shows that the question proposed by the Applicant for consideration that efforts for recovery of the loan were not made under the law by the Respondent is irrelevant and out of context as the ATIR allowed the provision of non-performing loans on the basis of decisions of the High Court and its earlier judgment to confirm that the banks follow the Prudential Banking Regulations of State Bank of Pakistan for writing off bad debts/loans; that the Respondent being a government controlled bank, all its transactions are subject to scrutiny of Public Accounts Committee and are also subjected to proper audits by internal and external auditors. Therefore, we are of the opinion that firstly the question does not arise out of the finding of the ATIR and secondly the efforts for recovery of loan is a question of fact, thus,cannot be adjudicated upon in the reference jurisdiction u/s 133 of Income Tax Ordinance, 2001.

13. For the foregoing reasons, the answer to questions No.1 is in **affirmative** in favor of Respondent Taxpayer. For proposed question No. 2, it is held that it does not arise out of order of the ATIR hence answer is declined. The instant reference application is, therefore, decided against the applicant department and in favour of Respondent. Copy of this order be sent to Registrar, Appellate Tribunal (Inland) Revenue.

(MOHSIN AKHTAR KAYANI)
JUDGE

(LUBNA SALEEM PERVEZ)
JUDGE

Announced in the Open Court on : 7th April 2020.

JUDGE

CHIEF JUSTICE

Junaid Usman