

JUDGMENT SHEET

ISLAMABAD HIGH COURT, ISLAMABAD,
(JUDICIAL DEPARTMENT)

I.T.R. No.376/2010

M/s Attock Gen. Ltd.

versus

Chief Commissioner Inland Revenue & 2 others

Applicant by: Mr. Shaukat Ali Qureshi, Advocate.

Respondents by: Mr. Babar Bilal, Advocate.

Date of Hearing: 01.07.2020.

MOHSIN AKHTAR KAYANI, J: Through this income tax reference, the applicant is aggrieved with the order passed by Income Tax Appellate Tribunal Islamabad, dated 05.08.2010, whereby claim of pre-commencement business loss/expenditure has been set aside by the Appellate Tribunal Inland Revenue, Islamabad.

2. Brief facts referred in the instant income tax reference are that applicant being a public limited company incorporated under the Companies Ordinance, 1984 filed its return of income tax for the year 2008 but the Commissioner Inland Revenue had selected the same for audit under Section 177 of the Income Tax Ordinance, 2001 as notified vide their letter dated 06.03.2009, regarding which a notice under Section 122(9), dated 06.05.2009, was issued to the applicant requiring to submit certain documents, which were provided by the applicant. However, Taxation Officer had disallowed the set off of pre-commencement business expenses/ losses incurred by the applicant in setting up a power generation plant. Feeling aggrieved thereof, the applicant filed an appeal before the Commissioner Inland Revenue (Appeals), which was decided in favour of the applicant vide order dated 14.12.2009. In response, Respondent No.2 filed an appeal against the said order before the Appellate Tribunal of Inland Revenue

(Respondent No.3), whereby the order of 14.12.2009 was reversed to the extent of allowance of adjustment of pre-commencement business expense/loss against the interest of income of the applicant vide impugned order dated 05.08.2010. Hence, the instant income tax reference.

3. After hearing both the learned counsel in the instant reference, this Court, vide order dated 19.05.2020, has framed the following questions.

1. *Whether the learned Tribunal (hereinafter called Respondent No.3) is correct in law in disallowing the set off of pre-commencement business expenses/losses, incurred by the applicant in setting up a power generation plant, from the interest of the applicant assessable under another head of income of income tax Ordinance, 2001?*
2. *Whether the selection of the applicant's tax matter for tax year 2008 for audit under Section 177(4) of the Income Tax Ordinance, 2001, without affording the opportunity to the applicant for explanation before selection, is lawful?*

4. Learned counsel for applicant contends that the learned Tribunal is not justified to disallow the set off of pre-commencement business loss/expenses out of the interest income of the applicant, as such, the same is also in violation of Section 56 read with Section 39 of the Income Tax Ordinance, 2001; that selection of the applicant's tax matters for tax year 2008 under Section 177(4) of the Income Tax Ordinance, 2001 without affording an opportunity before selection is *void ab initio* in view of the judgment of the apex Court reported as 1994 SC 317 Tax (CIT v. Fatima Sharif Textile, Kasur), therefore, impugned order of the Appellate Tribunal of Inland Revenue, dated 05.08.2010, may be modified to the extent by allowing set-off of pre-commencement business loss/expenses against the interest income of the applicant.

5. Learned counsel for respondents opposed the filing of instant income tax reference and contends that the view taken by the Appellate Tribunal of Inland

Revenue in the impugned order, is well reasoned and has been passed in accordance with law; that the management expenses of the applicant Company as well as the BF loss of the preceding year represent the total expenses incurred by the Company for the sake of business, therefore, attributable only to business income of the company, as such, they can be set off only against business profit of the applicant Company; that the learned Appellate Tribunal of Inland Revenue has rightly adjudicated upon the matter and passed the impugned order, which is liable to be maintained.

6. Arguments heard, record perused.

7. Perusal of record reveals that issue raised by the applicant is regarding the disallowing the set off of pre-commencement of business loss/expense incurred by the applicant in setting up of a power generation plant. The question was initially raised before the Assistant Commissioner Regional Tax Office, Rawalpindi who has discussed the claim of applicant's set off, where it was settled that the interest income of applicant being tax payer is actually his income from other sources under Section 39 of the Income Tax Ordinance, 2001, which is liable to tax and he is neither allowed to claim any deduction against the interest income nor to claim set off from his business loss against the interest income as per Section 25 of the Income Tax Ordinance, 2001, same is not business loss but pre-commencement expenditure.

8. The applicant having been aggrieved with the findings of the Assessment Officer filed an appeal before the Commissioner of Appeals, who has accepted the same vide order dated 08.12.2009 and disallowance made in respect of business loss was deleted. The respondent department has assailed the said order before the Appellate Tribunal Inland Revenue, whereby the question of

disallowance of management expenses has been discussed and appeal was allowed through the impugned order on the following reason.

"8. We have given due consideration to the observations of the learned taxation officer recorded at pages 8, 9 & 10 of the amended assessment order passed U/S 122(1) read with Section 122(5) of the Income Tax Ordinance, 2001 but do not feel persuaded to agree with his finding that the gain on conversion of foreign currency amounting to Rs.28186735/- was attributable to the circulating / floating capital for the reason that the gain relates to the pre-commencement stage of business and this fact has also been recorded by the taxation officer at page 7 of the Amendment assessment order. While discussing the admissibility or otherwise of the management expenses the taxation officer observed:

"The taxpayer's treatment of administrative and management expenses as business loss cannot be accepted because as the regular operation has not yet commenced; therefore, this figure can be treated as pre-commencement expenditure in the with Section 25 of the Income Tax Ordinance, 2001. Section 25 sub-section (5) define pre-commencement."

We fail to understand as to how the taxation officer came to the conclusion that the gain accruing to the taxpayer company from the conversion of its foreign currency was attributable to the floating capital when the business operations of the had not yet commenced. For this very reason i.e. non-commencement of business operations he categorized the management expenses of Rs.11584000/- as pre-commencement expenditure. Floating capital represents the amount out of which expenses are made with reference to day to day requirements which of business like purchase of raw material, stores, payment of wages, repair and maintenance etc. Such expenses are incurred only when the regular business operations of a concern are going on. The taxation officer, as discussed above has himself admitted that the business operations of the company have not yet commenced."

9. While considering the above position it is necessary to understand the concept of tax payers treatment of administrative and management expensive in terms of Section 25 of the Income Tax Ordinance, 2001, which deals with pre-commencement expenditure, whereby a person shall be allowed a deduction for any pre-commencement expenditure in accordance with this Section, which shall be amortized on a straight-line basis at the rate specified in Part-III of the Third Schedule. The term

pre-commencement expenditure means *any expenditure incurred before commencement of business wholly and exclusively to derive income chargeable to tax, including 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.*

10. From bare reading of above referred legal provisions, the pre-commencement expenditures have been explained, which exclude the administrative management expenses as claimed by the applicant in tax return 2008 at the Serial No.39 [Code 3189], amounting to Rs.11,584,000/- as the company has not yet commenced its business, whereas management and administrative expenses have not been covered under the pre-commencement expenditure.

11. We have also gone through the provision of Section 39 of the Income Tax Ordinance, 2001 which deals with income from other sources, which is chargeable to tax in that year and includes dividend, royalty, profit on debt, ground rent, income from lease of any building, plant, machinery, amenities, utilities, as such management expenses are not covered under the said head.

12. Similarly, Section 40 deals with deduction in computing income chargeable under the head "Income from other sources", which only allowed to be a deduction for depreciation of any plant, machinery or building used or initial allowance for plant or machinery and as such, claim of the applicant does not figure under the said provision.

13. The applicant has also raised the plea in terms of Section 56 of the Income Tax Ordinance, 2001 regarding his set off of losses, where a person sustains a loss for any tax year under any head of income specified in Section 11, the person shall be entitled to have the amount of loss as set off against the person's income,

but in this case the applicant company has not yet commenced its business and as such, the management expenses, though paid in shape of salaries to the employees, could not be claimed as set off of losses under any circumstance as the loss must be under the head of income from business, which has not yet been gained by the applicant in any manner as he has referred his tax return with nil in the year 2008.

14. The second issue raised by the applicant is that M/s Attock Gen Limited (Applicant) is a power generation company, whose case has been selected for audit under Section 177 of the Income Tax Ordinance, 2001 by the Commissioner Audit for the tax year 2008, regarding which the applicant contends that selection of applicant for audit is in violation of settled law as the criteria for selection by the Board has not been observed.

15. In order to understand the proposition, we have gone through the provision of Section 177 of the Income Tax Ordinance, 2001, whereby the Commissioner may call for any record or documents including books of accounts maintained under this Ordinance or any other law for the time being enforced for conducting audit of the income tax affairs of a person. However, said provision was amended through Finance Amendment Ordinance, 2009, whereby the Board may lay down the criteria for selection of person or classes of person for audit by the Commissioner. Whereas, applicant's case falls prior to the amendment of 2010 as reflected from assessment order, whereby the applicant was communicated vide letter dated 05.03.2009 by the Commissioner Audit for the Tax Year 2008, hence, selection itself by the respondent department is not unlawful, rather based upon certain factors and reasons, which persuaded the Commissioner Audit to select the applicant for the purpose of audit in terms of Section 177 of the Income Tax Ordinance, 2001.

16. The facts referred in the record clearly spell out that the applicant company has filed its return of income on 31.12.2008 as nil, the said return is treated to be assessment order under Section 120 of the Income Tax Ordinance, 2001 which was made basis of the selection for the purpose of audit, as such, no illegality has been highlighted by the applicant in the said scheme of law adopted by the respondent department, even otherwise, Income Tax Appellate Tribunal has considered all these aspects, but the applicant has not raised any such ground for its selection for the purpose of audit to be considered as illegal.

17. In view of above, we reply the phrased questions in **AFFIRMATIVE** as no illegality has been seen in the order passed by the Appellate Tribunal.

18. The reference stands disposed of accordingly.

(GHULAM AZAM QAMBRANI)
JUDGE

(MOHSIN AKHTAR KAYANI)
JUDGE

Announced in open Court on: 06th day of August, 2020.

JUDGE

JUDGE

Khalid Z.