Form No: HCJD/C-121

ORDER SHEET

IN THE ISLAMABAD HIGH COURT, ISLAMABAD
(JUDICIAL DEPARTMENT)

I.T.R.A. No.71/2008.

Commissioner of Income Tax (Legal), Large Taxpayer Unit, Islamabad

Versus

M/s Askari Commercial Bank Limited

Applicants by	:	Hafiz Munawar Iqbal, ASC Sayyid Murtaza Ali Pirzada, ASC
Respondent by	:	Dr. Ikram Ul Haq, ASC. Mr Mansoor Beg, ASC. Dr Farhat Zafar, ASC. Sh. Anwar ul Haq, ASC. Syyed Murtaza Ali Pirzada, ASC. Hafiz Munawar Iqbal, ASC.
Date of Hearing	:	11-12-2017

ATHAR MINALLAH, J.- Through this consolidated judgment, we shall decide the Income Tax References listed in Annexure 'A' attached hereto. With the consent of the learned counsels for the parties, the questions of law which have arisen from the judgments rendered by the learned Tribunal were formulated and have been articulated in Annexure 'B'. The Tax References have been divided into two categories i.e. Category 'A' and Category 'B'. The

Category 'A' References have been filed by the Department and the respondents therein are financial institutions, individually referred to as 'Banking Company' defined under clause (vii) of section 2 of the Income Tax Ordinance, 2001 (*hereinafter referred to as the* ***'Ordinance of 2001'***). The set of References in Category 'B' have been filed by one of the Banking Companies. The Banking Companies hereinafter will be referred to as the **'Banks'**.

2. The facts, in brief, are that the Banks are, inter alia, engaged in the business of attracting resources from customers and offering financing to others. The Banks are assessees and regularly file tax returns. Assessment orders were passed by the concerned Assessment Officers and these Tax References stem from the judgments rendered by the learned Tribunal. During the course of business the Banks, inter alia, invest in securities offered by the Federal Government which are issued under the Public Debt Act 1944 (*hereinafter referred to as the* ***'Act of 1944'***). The interest on such securities is paid and received according to the terms and conditions which are prescribed under the relevant rules framed in the exercise of powers conferred under section 28 of the Act of 1944 e.g SRO 735(I)/2000, dated 12-09-200. The controversy between the Department and the Banks is whether the interest on Government securities is required to be offered for taxation on accrual or cash basis. In some of the References an interpretation of the Income Tax Ordinance, 1979 (*hereinafter referred to as the* ***'Ordinance of***

1979') is involved while in others the relevant provisions of the Ordinance of 2001 are the subject of interpretation. The second question which we are required to answer is regarding the treatment of nonperforming loans or bad debts i.e. when and under what circumstances loans or debts are allowed to be treated as admissible expense. The third question of law relates to taxation of the loan which a Bank advances to its employees at concessional rates i.e its status in the context of section 24(i) of the Ordinance of 1979. The Department had also proposed questions of law relating to interest credited to a suspense account. However, the learned counsels for the Banks drew our attention to the order dated 21-02-2017, passed by the august Supreme Court in Civil Appeal No.08/2017 titled *'Deputy Commissioner Income Tax v. M/s Habib Bank AG Zurich'* in support of their contention that this issue stood settled on the basis of the letter/instructions, dated 23-11-2005, which has been explicitly mentioned in the aforementioned order. This statement was not contested before us on behalf of the Department and, therefore, the Tax References to the extent of the questions relating to interest credited to a suspense account are disposed of in similar terms as the august Supreme Court had disposed of the appeal vide order dated 21-02-2017. Moreover, the questions of law in respect of profit and loss expenses were also proposed by the Department in some of the References but have not been pressed and, therefore, we need not consider or answer the same. As noted above, we will be answering questions of law which have been proposed for our consideration and are mentioned in Annexure 'B'.

3. The learned counsels for the Department have argued that; the interest on securities under the Ordinance of 1979 was governed under section 17(1) and its method of accounting was described under section 32 ibid; the interest derived from securities was required to be offered for tax on accrual and not on cash basis; this was further reaffirmed under the repealing statute i.e. the Ordinance of 2001, particularly sections 34 and 32 ibid; the Banks are under an obligation to account for income relating to Government securities on accrual basis as it falls under the head 'income from business'; the Banks adopt a mercantile system of accounting and, therefore, they were and continue to be under an obligation to offer interest on securities for the purposes of chargeability of income tax on accrual basis; under section 23(1)(x) of the Ordinance of 1979, the assessing officer was exclusively empowered to ascertain whether the loan had become irrecoverable otherwise deduction was not permissible by the Banks on their own; mere bad debts/non-performing loans cannot be claimed as expense; the claim regarding admissibility of bad debts/non-performing loans as expense was and continues to be restricted to such loans which become irrecoverable; the assessee cannot claim adjustment of the loan as an expense unless it has become irrecoverable; the question of whether bad debts have become irrecoverable involves objective and factual

determination; if it is a secured loan then it cannot be treated as irrecoverable under the Ordinance of 2001; section 29 regulates taxation in relation to Bad Debts; neither under the Ordinance of 1979 nor the Ordinance of 2001 concessional loans given by the Banks to its employees were exempt to the extent of difference in the rate of interest; such loans attract section 24(i) of the Ordinance of 1979; section 25 of the Ordinance of 1979 and section 13 of the Ordinance of 2001 prescribes guidelines for the purposes of determination of perquisites.

4. The arguments advanced by the learned counsels who have appeared on behalf of the Banks may be summarized as; the question regarding taxation of interest on securities i.e on accrual or receipt basis stands settled in the light of the judgment of the august Supreme Court rendered in the case of *'Commissioner of Income Tax v. Habib Bank Limited and ANZ Grindlays Bank PLC'* [2014 SCMR 1557]; the Banks adopt hybrid accounting system and, therefore, interest is required to be offered for the purposes of taxation when it is actually received and not on accrual basis; the learned Tribunal has consistently held in several judgments that under section 34(2) read with section 32 of the Ordinance of 2001 the Banks become entitled to interest on the date of its actual receipt and not before i.e. on accrual basis; section 32 of the Ordinance of 1979 provides that profit and gains of a person shall be charged on the basis of method of accounting which is regularly employed by the assessee; a person

becomes entitled to receive interest when it has become due i.e. when the payment is actually received; section 17 of the Ordinance of 1979 explicitly provided that interest from securities were liable to be taxed on receivable basis; the expression 'receivable' has not been defined under the Ordinance of 1979; under section 22 of the Act of 1944 a person is not entitled to claim interest in respect of any period which has lapsed after the earliest date on which demand could have been made for the payment of amount due thereon and thus the entitlement is reckoned from the date when the interest is actually received; the mere recording of receipts or expenses in the financial statement is not by itself sufficient to make such receipts or expenses chargeable to tax; reliance has been placed on *'Messrs MCB Bank Ltd. v. Commissioner Inland Revenue'* [2014 PTD 1874]; the concessional loans given to the employees do not attract section 24(i) of the Ordinance of 1979.

5. The learned counsels have been heard and the record perused with their able assistance.

6. As noted above, we have been called upon to answer questions of law relating to three issues. The tax years regarding which respective assessment orders were passed inevitably requires an interpretation of the Ordinance 2001 and the repealed Ordinance of 1979. It would, therefore, be apt to discuss each issue separately.

A. Tax treatment of interest on Government Securities, Whether Banks were/are obliged to offer income for purposes of chargeability of tax on accrual or actual receipt basis.

7. The Ordinance of 1979 was repealed by the Ordinance of 2001. The expression 'Banking Company' was defined under section 2(10) of the repealed Ordinance of 1979 and now under section 2(7) of the Ordinance of 2001. The Banks fall within the ambit of the said expression. Before surveying the relevant provisions of the two aforementioned statutes, it would be beneficial to briefly examine the methods employed for accounting purposes. Accounting methods consist of rules and guidelines regarding the keeping of financial records and reports. The two basic methods used for record keeping are 'cash basis' and 'accrual basis'. The method known as on 'accrual basis' is also referred to as the 'mercantile system' of accounting. Under the accounting method, also termed as on 'cash basis', income is recorded in the accounts in a tax year when it is actually received while on the other hand under the 'accrual basis' of accounting, income is recorded when it is earned rather than its actual receipt. In other words, in the case of the accounting method described as on 'accrual basis' or 'mercantile system', the transactions are recorded regardless of the period when the amount of revenue or income is actually received. There is also another category of accounting method which is referred to as the 'hybrid system'. The latter is a combination of 'cash' and 'accrual' basis of accounting. The

distinguishing factor between 'cash' and accrual' methods of accounting is the timing when revenues and expenses are recorded in the Books of Accounts. Under the method of accounting termed as on 'cash basis', revenues for the purposes of determining income is recognized when cash is actually received. It does not recognize receivables or amounts payable. On the other hand, under the accounting method of 'accrual basis', income and expenses are recorded in the books of accounts when they are earned, notwithstanding the timing of actual receipt. This difference in the two accounting methods is crucial for the levy and charge of tax. In a nut shell, the income of an assessee which/who employs the method of accounting known as on 'accrual basis', is offered for chargeability of tax in the tax year when it is earned and recorded as such in the accounts. Likewise, in the case of 'cash basis' of accounting method the income is recorded when the revenues are actually received and, therefore, it becomes chargeable to tax in the corresponding tax year. These two methods are internationally recognized and uniform accounting systems used for recording transactions, determining profit and loss and consequently offering income for taxation purposes. Generally small businesses and individuals employ the 'cash basis' accounting method while large business entities adopt the method on 'accrual basis'. In case of the 'cash basis' accounting an assessee is not under an obligation to record income before it is actually received while 'accrual basis' requires that income is declared and recorded in the books of accounts when it becomes receivable regardless of its actual payment. It is noted that the International Financial Reporting Standards are based on accrual based accounting. The Banks prepare and publish their accounts on accrual basis. The legislature, while enacting the Ordinance of 1979 or the Ordinance of 2001, as the case may be, appears to have been cognizant of the accounting methodology recognized and followed globally. This will become obvious from the survey of the two statutes discussed in the paragraphs which are to follow.

8. The relevant provisions under the Ordinance of 1979, which requires our attention and deals with taxation of interest on securities, are sections 17(1) and 32 ibid. Section 17(1) describes the categories of income which are chargeable under the head interest on securities and it, inter alia, includes interest on securities of the Federal Government or Provincial Government receivable by an assessee in any income year. Section 32 expressly provides the method of accounting, inter alia, for the purposes of section 17. It explicitly provides that income, profits and gains shall be computed in accordance with the method of accounting regularly employed by the assessee. The Ordinance of 1979, for the purposes of computing income, profit and gains in the context of section 17, had left the selection of the method of accounting to the assesee. The latter, therefore, could either adopt cash or accrual basis of accounting method unless the then Central Board of Revenue (renamed as Federal Board of Revenue), in the exercise of powers vested under

sub section (2) of section 32, had prescribed the form and manner for maintaining the accounts through a general or special order. In the event that an assessee had not regularly employed one of the accounting methods, the Deputy Commissioner was vested with power under sub section 3 of section 32 to compute income in such manner as the latter thought fit. In the present References, sub sections (2) and (3) are not relevant because on the factual side it has been explicitly determined by the lower forums that the Banks had regularly employed the mercantile or in other words the accounting method on 'accrual basis. This is also implicit from the arguments made before us on behalf of the Banks. The learned counsels for the Banks have strenuously argued that the expression 'receivable' used in section 17(1)(a) of the Ordinance of 1979 is crucial. The said expression was not defined under the Ordinance of 1979. The Black's Law Dictionary Eighth Edition defines the expression 'receivable' as follows.-

> **receivable,** *adj.* **1.** Capable of being admitted or accepted <receivable evidence>. **2.** Awaiting receipt of payment <accounts receivable>. **3.** Subject to a call for payment <a note receivable>.
> **receivable,** *n.* An amount owed, esp. by business's customer. *See account receivable under ACCOUNT.*
> ***unrealized receivable.*** An amount earned but not yet received. • Unrealized receivables have no income-tax basis for cash-basis taxpayers. [Cases: Internal Revenue - 3931, 3935.]

9. It is obvious from the above dictionary meaning of the expression "receivable" that by no stretch of the imagination can it be construed as involving actual receipt of income. Moreover, under the

International Accounting Standards, 'receivable' is distinct from actual receipt of income. It is the settled law of interpretation of a statute that provisions are required to be read in its context. In the case of a taxing statute the Court has to look to the clear words since there is no question of any intendment, nor is there any presumption or equity about tax. Nothing can be read or implied in the taxiing 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. We therefore hold that the timing for offering income for taxation purposes relating to interest on securities under the Ordinance of 1979 was solely dependent on the method of accounting which was regularly employed by the Banks. If the method of accounting termed as on 'cash basis' was employed then income was required to be recorded in the books of account in the tax year when the interest or part thereof was actually received. In the case of the instant References, on the factual side, it stands determined that the Banks were regularly following and had adopted the mercantile, or in other words the 'accrual basis' of accounting method. This was never contested by the Banks. Moreover, it is not the case of the latter that income from interest was recorded in the accounts on the basis of actual receipt nor that the recording of income in the books of accounts was based on the method of accounting known as on 'cash basis'. We have carefully gone through the judgment of the august Supreme Court rendered in the case titled *'Commissioner of Income Tax v. Habib Bank Limited and ANZ Grindlays Bank PLC'* [2014 SCMR

1557] and we feel that our above interpretation stands fortified. In the facts before the august Supreme Court, the respondent Banks had adopted the method of accounting which was hybrid while in the instant tax References the method employed was mercantile or on accrual basis. The august Supreme Court has affirmed in the said judgment that the regularly adopted method of accounting by an assessee will inevitably determine the tax liability in the case of interest on securities. As the interest on securities were not recorded in the accounts of the Bank on 'cash basis' i.e when actually received or paid, therefore, the relevant tax year was when they were shown or recorded in the accounts as receivable or earned.

10. Now we shall advert to the relevant provisions of the Ordinance of 2001. In the case of the said statute the relevant provisions relating to the Banks in this regard are sections 18(2), 32, 33, 34 and 100 A read with the Seventh Schedule. Section 18(2) provides that any profit on debt derived by a person, where the latter'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'. Sub section (1) of section 32 provides that, subject to the Ordinance of 2001, a person's income chargeable to tax shall be computed in accordance with the method of accounting regularly employed by such person. Sub section (2) further provides that, subject to sub section (3), a company shall account for income chargeable to tax under the head 'Income from Business' on accrual

basis, while other persons may account for such income on cash or accrual basis. Sub section (3) of section 32 empowers the Board to prescribe that any class of persons shall account for income chargeable to tax under the head income from business on a cash or accrual basis. Sub section (4) of section 32 makes it mandatory for a person to apply in writing for a change in the person's method of accounting and the Commissioner may, by order in writing, approve such an application but only if satisfied that the change is necessary to clearly reflect the persons income chargeable to tax under the head income from Business. Sub section (5) of section 32 provides that if a person's method of accounting has changed, then such person shall make adjustments to items of income, deduction or credit or to any other items affected by the change so that no item is omitted and that no item is taken into account more than once. Section 33 explains that a person accounting for income chargeable to tax under the head 'Income from Business' on cash basis shall derive income when it is received and shall incur expenditure when it is paid. Likewise sub section (1) of section 34 describes that a person's accounting for income chargeable to tax under the head income from business on accrual basis shall derive income when it is due to the person and shall incur expenditure when it is payable by the latter. Sub section (2) of section 34 unambiguously provides that, subject to the Ordinance of 2001, an amount shall be due to a person when the latter becomes entitled to receive it even if the time for discharge of the entitlement is postponed or the amount is payable by installments. Section 100 A of the Ordinance of 2001 was inserted through the Finance Act 2007 which was assented to on 30-06-2007. The said provision explicitly provides that income, profits and gains of any Banking Company defined in clause (7) of section 2 and the tax payable thereon shall be computed in accordance with the rules prescribed in the Seventh Schedule. However, the provision of section 100 A was explicitly made applicable to the profits and gains of the Banking Companies relevant to the tax year 2009 and onwards, as explicitly provided under section (2) ibid. The relevant expressions in the context of the controversy at hand are 'Banking Company', 'Company', 'Financial Institution', and 'person' which are defined under sections 2(7), 2(12), 2(24) and 2(42) of the Ordinance of 2001 respectively.

11. The expressions 'due' and 'entitled' are crucial for the adjudication of these Tax References, since a great deal of emphasis has been laid by the learned counsels and the leaned Tribunal has also interpreted the expression 'entitled' as meaning the actual receipt of interest by the Bank. The expression 'due' used in sub section (1) of section 34 has been explained in sub section (2) and it is essentially in the context of the method of accounting referred to as on 'accrual basis'. Sub section (2) of section 34 provides, that subject to the Ordinance of 2001, an amount shall be due to a person when the latter becomes entitled to receive it even if the time for discharge of the entitlement is postponed or the amount is payable by

installments. The expression 'entitled' has not been defined under the Ordinance of 2009. The said expression is defined in various dictionaries. The Burton's Legal Thesaurus, Fifth Edition defines the expression 'entitled' as follows.-

> "**ENTITLED.** ***Adjective.*** allowed, authorized, deserved, deserving, desirable, due, earned, eligible, empowered, fit, having the right, justified, labeled, legalized, licensed, merited, ordained, permitted, privileged, qualified, sanctioned, suitable, warranted, worthy"

Advanced Law Lexicon Volume II (Reprint 2009):-

> **Entitled.** Having a title to.
> "The word 'entitled' in Art. 5(4) [of the European Convention on Human Rights] connotes an enforceable right." R. (D.) v. Secretary of State for the Home Department, (2003) 1 WLR 1315, 1327 QBD per STANLEY BURNTON J. (Stroud, 6th Edn., 2000, Supplement 2003)
> SEE ALSO (1) 'ABSOLUTELY ENTITLED'; (2) 'ACTUALLY ENTITLED'; (3) 'BENEFICIALLY ENTITLED', (4) 'PERSON ENTITLED'.
>
> **Entitled as of right.** Having a title as a matter of his right.
>
> **Entitled as of right to practice.** The phrase 'entitled as of right to practice' is an emphatic affirmation of a right to plead and to act independently of the will or discretion of any other person. *Asvini kumar chuse v. Arbinda Bose, AIR 1952 SC 369, 377. (S. 2 Supreme Court Advocates (Practice in High Court) Act (18 of 1951)).*
>
> **Entitled consumer.** "ENTITLED CONSUMER" means a person in a cantonment who is paid from the Defence Services Estimates and is authorized by general or special order of the Central Government to receive a supply of water for domestic purposes from the Military Engineer Services or the Public Works Department on such terms and conditions as may be specified in the order. [Cantonments Act (2 of 1924), s. 2(xi-c).
>
> **"Entitled to"** as applied to estates generally embraces every interest of every kind which the party in question has any title to whatever, whether it be an estate or interest in possession, in remainder or reversion, either vested or contingent. (Wilton v. Colvin, 3 Drew. 617).
>
> "ENTITLED TO" "SEIZED", 'POSSESSED OF". The word "seized", or "possessed of", or "entitled to", are generally used to mean the same thing and very frequently occur in

Settlements and wills, and other instruments where undefined property is dealt with by general words.

Entitled to act. The following persons shall be deemed persons "ENTITLED TO ACT" as and to the extent hereinafter provided (that is to say)—
Trustees for other persons beneficially interested shall be deemed the persons entitled to act with reference to any such case, and that to the same extent as the persons beneficially interested could have acted it free from disability.
A married woman, in cases to which the English law is applicable, shall be deemed to the person so entitled to act and whether of full age or not, to the same extent as if she were unmarried and of full age; and
The guardian of minors and the committees or managers of lunatics or idiots shall be deemed respectively the persons so entitled to act, to the same extent as the minors, lunatics or idiots themselves, if free from disability, could have acted:
Provided that -

(i) no person shall be deemed "entitled to act" whose interest in the subject-matter shall be shown to the satisfaction of the Collector or Court to be adverse to the interest of the person interested for whom he would otherwise be entitled to act;

(ii) in every such case the person interested may appear by a next friend or, in default of his appearance by a next friend, the Collector or Court, as the case may be, shall appoint a guardian for the case to act on his behalf in the conduct thereof

(iii) the provisions of [Order XXXII of the Schedule to the Code of Civil Procedure, 1908 shall, mutatis mutandis, apply in the case of persons interested appearing before a Collector or Court by a next friend, or by a guardian for the case, in proceedings under this Act; and

(iv) a person "entitled to act" shall be competent to receive the compensation money to the person for whom he is entitled to act unless he would have been competent to alienate the land and receive and give a good discharge for the purchase money on a voluntary sale. [Land Acquisition Act (1 of 1984), S.3(g)]

Entitled to avoid. Having a title to avoid i.e. to make null [S.19A, Indian Contract Act (9 of 1872)]

Entitled to possession. The expression "entitled to possession" means that in the case of stolen property the person who originally lost it is entitled to possession of the same. The person who purchase it in good faith for value is only entitled to be compensated. *Roshan Lal v. The State, AIR 1957 Punj 297, 299, [CrPC 1973 (2 of 1974), Ss.452(1) &(2) and 453]*

Entitled to retain. Having a title to hold or continue to hold in possession or use [S. 170, ill. (a) Indian Contract Act (9 of 1872)]; [S. 47(1), Sale of Goods Act (3 of 1930)].

The Cambridge Dictionary Tenth Edition:-

Entitle */en-t I tle/ vt* to give a title to; to style; to give a right or claim to [*OFr entitler*, from *LL initulare*, from in, and *titulus* title].

- **Entitlement** *n* something to which one has a right or claim.

Black's Law Dictionary Ninth Edition:-

Entitle. *Vb.* (14c) 1. To grant a legal right to or qualify for. 2. Eccles. Law. To ordain as a minister.—former also spelled as intitle.
entitlement. (19c) An absolute right to a (usu. Monetary benefit, such as social security, granted immediate upon meeting a legal requirement [Classes Social Security and Public Welfare - 1.10.].

Concise Oxford English Dictionary Twelfth Edition:-

Entitle *v.* 1 (often to be entitled to) give someone a right to do or receive something. 2. Give a title to (a book, play, etc.)
DERIVATIVES **entitlement** n.
ORIGIN ME: via Ofr. From late L. entitas, from late L. initiulare, from in 'in + L. titulus 'title'.

Words and Phrases Paramount Edition Volume 14B:-

ENTITLE
Ariz.App. 1966. An instruction that if decedent failed to control his automobile which collided with parked truck and such negligence proximately caused or proximately contributed to cause of death then the plaintiff "is not entitled to recover" was not erroneous for use of quoted words as being imperatively directive, particularly in view of trial court's basic instruction delineating the four "issues" of the case, in which jury was told that if it found contributory negligence jury "may" find for defendant the word "entitle" meaning "to give title to". A.R.S.Const, art. 18, § 5.—Schrnidt v. Gib-bons, 412 P.2d 716, 3 Ariz.App. 147, opinion vacated 4]8 P.2d 378, 101 Ariz. 222.—Trial 194(16),296(4).
Kan. 1912. Chapter 101 of the Laws of 1905 requires registration with the State Auditor of public utility bonds issued by cities, "and the said
Auditor shall be entitled to a fee of not exceeding fifty cents for each bond so registered in his office." Held, that such fees collected by the plaintiff when Auditor belonged to him, and he was not required by section 4, c. S, of Laws of 1909, to account for or turn them over to the State Treasurer; "entitle" meaning to give a claim right or title to.-—Nation v.Tully, 121 P. 507, 86 Kan. 564.

ENTITLED
U.S. 2005. A person cannot safely be deemed "entitled" to something, for purpose of determining whether person has protected due process interest, when the identity of the alleged entitlement is vague. U.S.C.A. Const. Amend. 14.—

> Town of Castle Rock, Colo. V. Gonzales, 125 S.Ct. 2796.-Const Law 252.5.
>
> C.A.3 (N.J.) 2001. In order for individual to be "entitled" to benefit under ERISA, and thus entitled to plan documents, it is not necessary that she establish that she had meritorious claim; it is sufficient if she demonstrates that she had colorable claim that she will prevail in suit for benefits. Employee Retirement Income Security Act of 1974, 2(8), 104(b)(4), 29 U.S.C.A. 1002(8), 1024(b)(4).-Daniels v. Thomas & Betts Corp., 263 F.3d 66. – Labor & Emp 481.
>
> D.Md. 1972, Word "entitled" within statute authorizing judicial review of a final decision of Secretary of Health, Education and Welfare pertaining to entitlement of benefits under medicare Act provided amount in controversy exceeds $1,000 is to be given its ordinary meaning, that is, whether a person is entitled to payment for particular service or illness, and is not to be read as a term of art in sense of whether an individual is entitled to any coverage at all. Social Security Act, 1869(b), 42 U.S.C.A. 13 95ff(b).-Ridgely v. Secretary of Dept. of Health, Ed. And Welfare, 345 F. Supp. 983, affirmed 475 F.2d 1222.—Health 566(2).

12. It is obvious from the above definitions of the expression 'entitled' given in various dictionaries that by no stretch of the imagination can it be construed as having reference to actual receipt of income. Moreover, part of section 34 cannot be interpreted in isolation. Section 34 as a whole explains one of the two methods of accounting which is known as on 'accrual basis'. The other method i.e 'cash basis' has been described in section 33. The learned Tribunal, in disregard to the settled principles of interpretation of statutes, has read the expression 'entitled to receive' in isolation. The learned Tribunal has in particular excluded from consideration sub section (2) of section 34 in its entirety which expressly provides that 'an amount shall be due to a person when the person becomes entitled to receive ***it even if the time for discharge of the entitlement is postponed or the amount is payable in installments".*** The later

part of the said statutory provision expressly affirms that 'entitled to receive' definitely does not refer to, or has the meaning of actual receipt of the interest, so as to trigger chargeability to tax under the Ordinance of 2001. Accepting the interpretation of the learned Tribunal would render the entire section 34, except the expression 'entitled to receive', as redundant. Moreover, sections 32 and 33 will also become redundant.

13. The settled principles of interpretation of a fiscal statute are that the provisions are required to be interpreted literally and equity or presumption are alien thereto; if a provision of a taxing statute can have two reasonable explanations then one which is favourable to the taxpayer has to be accepted; any ambiguity is required to be resolved in favour of the tax payer. Likewise, redundancy cannot be attributed to the lawmaker. Every word and part of the statute has to be given meaning and effect. It is always presumed that the legislature has used every word in a context and for a purpose. The statute has to be read as a whole and the intention of the legislature has to be discovered by paying attention to what has been said. Applying these principles for the purposes of interpreting sections 18(2), 32, 33, 34 and 100 A, read with the Seventh Schedule of the Ordinance of 2001, we have no hesitation in observing that the learned Tribunal has, with great respect, not properly appreciated the legislative intent by reading the relevant provisions together.

14. A plain reading of the above provisions together unambiguously shows that there was no material departure made by the legislature while enacting the Ordinance of 2001 in juxtaposition of the repealed Ordinance of 1979. Rather, the provisions of the Ordinance of 2001 have introduced more clarity in this regard. The provisions of both the statutes clearly affirm that the legislature was mindful of the two methods of accounting envisaged under the International Accounting Standards i.e accrual and cash basis. Under the Ordinance of 2001 it has been unequivocally provided that profit on debt derived by an assessee shall be chargeable to tax under the head 'Income from Business' and, subject to the other provisions, it is mandatory to compute the same in accordance with the method of accounting which is regularly employed by such person. In the case of a company it is mandatory for the latter to compute the chargeable tax on accrual basis under the head 'Income from Business' while other persons may account for such income on cash or accrual basis unless it has been otherwise prescribed by the Federal Board of Revenue, pursuant to powers vested under section 32(3). The Banks are admittedly incorporated and individually they all fall within the ambit of the expression 'company' as defined in the Companies Ordinance, 1984. Each individual Bank is, therefore, a 'company' within the meaning of the said expression under section 2(12) read with section 80(1)(b) of the Ordinance of 2001. It is thus mandatory for the Banks to account for chargeability to tax under the head

'Income from Business' on accrual basis. The distinction between accounting on cash basis or accrual basis is explained under sections 33 and 34 respectively, which is in consonance with the methods of accounting which are recognized under the International Accounting Standards. The legislature, by inserting section 100 A and the Seventh Schedule through the Finance Act 2007, inter alia, has provided that income, profits and gain 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. The learned Tribunal had indeed misinterpreted the provisions of sections 32, 33 and 34 by confining its attention to the expression 'entitled to receive' and consequently had excluded from consideration other provisions which essentially had the effect of rendering them redundant.

15. It is not the case of the Banks that they have regularly employed 'cash basis' as the method of accounting for recording income which is derived from interest on Government securities. On the contrary, the Banks acknowledge that they have regularly employed the method of accounting termed as on 'accrual basis' for recording income derived from interest on Government securities i.e as receivables and earned regardless of the time of actual receipt. The recording of income by the Banks in their respective accounts in respect of interest from securities in a tax year as receivable or earned by employing the method of accounting on 'accrual basis',

explained under section 34, is the relevant and crucial event for chargeability of tax under the Ordinance of 2001.

16. Keeping in view the above discussion we hold that the Banks, having regularly employed the method of accounting on mercantile or accrual basis, were and continue to be under an obligation to record income derived from interest on securities from Government securities when they are earned or become receivable, notwithstanding the actual receipt of such interest. The test is simple and is dependent on the method of accounting regularly employed in this regard. We are afraid that the learned Tribunal has not construed the above discussed provisions having regard to the obvious intent of the legislature, since the language used is free from any ambiguity. As a consequence, income tax will be chargeable to tax under the Ordinance of 2001 during the tax year when the income derived from interest on Government securities is recorded in the accounts as receivable or earned and not when it is actually received in installments' or upon maturity, as the case may be. It would have been otherwise if the Banks were regularly employing the method of accounting on cash basis because there under a person is not required to declare or record income unless actually received.

B. Bad Debts / Non – Performing Loans

17. Under the repealed Ordinance of 1979, Bad Debts were dealt with under section 23(1)(x). The said provision contemplated that in computing income under the head income from business, the allowance and deduction shall be made in respect of Bad Debts to the extent of such amount which did not exceed the amount actually written off by the assessee as may be determined by the Deputy Commissioner to be irrecoverable. The relevant expressions used in the aforementioned provision are 'Bad Debts' 'actually written off' and 'irrecoverable'. These expressions were not defined in the Ordinance of 1979 nor have they been defined under the Ordinance of 2001. A plain reading shows that computing of income, allowances or deduction in respect of bad debts is based on two fundamental factors, firstly, it is restricted to the amount actually written off and, secondly, the Bad Debt must be irrecoverable. On what basis was the Deputy Commissioner required to determine that the loan or debt had become irrecoverable? How is a loan or debt written off? Section 23(1)(x) explicitly deals with Bad Debts in the context of financial institutions such as the Banks and, therefore, the answer necessarily has to be explored under the regulatory framework governing the Banks and the loans advanced by them during the course of business. The Banks are governed under the regulatory framework of Prudential Regulations issued by the State Bank of Pakistan. However, before we

undertake this exercise it would be beneficial to examine the relevant provision of the Ordinance of 2001, which is section 29 ibid. The conditions prescribed therein for a person to be entitled to deduct a bad debt in a tax year are as follows;

(i) The amount of the debt was previously included in the income and was in respect of money lent by a financial institution in deriving income chargeable to tax.

(ii) The debt or part of the debt was written off in the accounts of the person in the tax year; and

(iii) there were reasonable grounds for believing that the debt was irrecoverable.

18. The person claiming deduction for a bad debt in a tax year is required to meet the above conditions in order to claim deduction. It may be noted that under the Ordinance of 1979 the debt for the purposes of deduction had to be determined as irrecoverable by the Deputy Commissioner while in case of the Ordinance of 2001 the condition would be satisfied if there existed 'reasonable grounds for believing that the debt is irrecoverable'. This change in the language manifests that, unlike the Ordinance of 1979, the determination relating to recoverability of a loan is not to be made by the Deputy Commissioner, rather, under the Ordinance of 2001 the assessee, at the time of filing the tax returns, has to determine this aspect on the

basis of the existence of reasonable grounds thereof. This change is in consonance with the scheme of the Ordinance of 2001 which is based on the theme of self assessment while that was not the case under the repealed statute. Nonetheless, under both the statutes the entitlement for the purposes of deduction of bad debt in a tax year essentially has a nexus with the debt becoming irrecoverable. What then can be reasonable grounds for believing that the debt has become irrecoverable? This will be elaborated later. Sub section 2 of section 29 restricts permissible deduction by explicitly providing that in a tax year it shall not exceed the amount of debt written off in the accounts of the assessee. The legislature, through the Finance Act 2007, manifested its intent, inter alia, in relation to the treatment regarding non performing loans by inserting section 100 A and the rules specified in the Seventh Schedule. It expressly acknowledges and refers to the Prudential Regulations issued by the State Bank of Pakistan in relation to a Banking Company for computing income under the Ordinance of 2001. These special provisions exclusively deal with banking business and, therefore, have to be interpreted harmoniously with section 29 in the context of bad debts. It was for the first time that non performing loans were dealt with for the purposes of computing income of a Banking Company in a tax year. At this stage the distinction between a non performing loan and written off debt needs to be probed. This would also answer the question as to when a loan becomes a bad debt and thus irrecoverable. This distinction is crucial because the expression 'non performing loan' was not mentioned under the repealed Ordinance of 1979 nor under the Ordinance of 2001 before the insertion of the rules under the Seventh Schedule.

19. As noted above, the business of the Banks is regulated by the State Bank of Pakistan. The latter from time to time issues regulations which are known as Prudential Regulations. The State Bank of Pakistan through the Prudential Regulations has classified debts in three categories on the basis of the period of default on the part of the borrower. They are 'sub standard', 'doubtful' and 'loss'. Annexure (V) of the Prudential Regulations titled 'All Financing Facilities (including Short, Medium and Long Term)' has described these three distinct categories. A debt becomes 'substandard' if the payment is overdue for ninety days or more, 'doubtful' if the delay is one hundred and eighty days and it is reclassified as 'loss' when the default on part of the borrower is for more than three hundred and sixty five days. These three categories are covered under the expression 'non performing loans' and are recorded in the balance sheet as an asset. A debt classified as nonperforming is not 'irrecoverable'. It continues to be recorded as an asset till it has been eliminated from the balance sheet when the financial institution is satisfied that it is no more recoverable. This event of declassification of the debt as an asset in the books of accounts is termed as 'write off'. A loan is written off when the financial institution, having regard to the guidelines of the regulator, has declared it as such. It is only

when the debt has been declared as written off that it is treated as having become irrecoverable notwithstanding that at a later stage recovery may be affected. The State Bank of Pakistan, in its capacity as a regulator, has prescribed guidelines for treating a debt as a write off vide BPRD Circular No. 06, dated 05-06-2007, and the relevant portions are as follows:

> "*4. Before considering/processing of a write off proposal, the banks/DFIs shall adhere to following minimum guidelines:-*
>
> *i) All liquid securities/assets, as defined in Prudential Regulations for Corporate and Commercial Banking, held by bank/DFI under lien, pledge etc have been realized and sale proceeds thereof have been appropriated towards adjustment of outstanding amount of principal.*
>
> *ii) Confirmation by the concerned official of the branch/office duly countersigned by the authorized official(s) of the office higher than the originating branch/office that borrower or his guarantor has no known means of repayment.*
>
> *iii) The borrower(s) has not created other business interests and assets out of the non performing loans proposed to be written off.*
>
> *iv) The borrower(s) is not involved in any criminal misappropriation of stocks, movable and immovable assets or security (ies).*
>
> *v) The write off of loans/advances, if any, in the names of Directors or their relative/dependent(s)/concern(s) in which they have any interest of 5% or more and in the*

name of Chief Executive of the bank/DFI shall require prior approval of State Bank of Pakistan (SBP).

vi) *No write off will be allowed where forced sale value of securities held, is more than the recoverable outstanding amount. However, the said condition shall not be applicable on the cases recommended/settled under any general incentive scheme of SBP or such other Committee(s) as notified by SBP or present Committee for Revival of Sick Industrial Units (CRSIU).*

vii) *The write off proposal is duly audited by the internal auditor (IA) of the bank/DFI. The IA shall clearly indicate the deviation/irregularity, if any, from the approved credit policy during the process of sanction, disbursement, documentation, monitoring/supervision of loan/advance and its underlying security(ies). The name(s) of official(s) responsible for irregularities/lapses, which has turned the loan/advance partially or fully bad/irrecoverable, may clearly be spelled out along with action taken against such official(s). It is clarified that IA would only verify the facts and figures as put forth by the concerned Department(s)/office(s) and need not give recommendation or otherwise.*

viii) *The latest valuation of properties/stock/other assets held by banks/DFIs as security for the loan/advance shall be obtained, if not available on record, at the time of write-off of loans, indicating clearly therein, amongst others, the present market value as well as forced sale value. The condition of valuation of properties/stocks/other assets held as security for the loans/advances shall be restricted to cases involving outstanding principal amount of Rs 5 million and above and have to be conducted through an* *approved surveyor on the list of Pakistan Banks Association. The valuation of properties/stocks/other assets for determining market and forced sale value having outstanding principal amount of less than Rs 5 million may be done by bank/DFI itself as it deem appropriate in a reasonable and transparent manner.*

ix) For writing off of loans/advances, where outstanding amount of principal is below Rs. 0.5 million, the clauses stipulated at para 4(vii) and (viii) shall not be applicable. The banks/DFIs while following clauses at 4(i) to (vi) in said cases shall also obtain a joint certificate from originating branch manager and an authorized officer of the said branch duly countersigned by the authorized official(s) of the office higher than the originating branch confirming that no irregularity/deviation of prescribed rules and regulations in the process of sanction, disbursement, documentation, monitoring/supervision of loans/advances and its underlying security(ies) has occurred which has turned the loan/advances partially or fully bad/irrecoverable. The name(s) of the official(s) responsible for the irregularity(ies)/lapses may be clearly spelled out along with action taken against such official(s)."

Moreover, vide BPRD Circular No.12 of 2014 dated, 24-11-2014, the following guidelines have has been issued:

"2. The irrecoverable / bad loans, advances or financing shall continue to be written off by the banks/DFIs with the approval of respective Board of Directors (BOD) under a well defined and transparent write off policy. The policy

shall cover financial relief in the form of write off of principal, debited mark-up/profit and reversal/waiver/remission of undebited mark-up and other charges etc. The policy may cover peculiar situations such as widows, orphans and scenarios where natural calamities impair the prospect of recovery etc. The BOD at their discretion may delegate adequate and appropriate powers down the line to the President/Chief Executive Officer and other senior officers of the bank/DFI as they deem fit. The BOD shall ensure the transparency of the process so that loan, advance or financing is written off only when there are no realistic prospects of recovery. Besides, the BOD shall also ensure the prudent management of write offs/waivers under delegated powers and effective internal systems and controls to avoid any type of misuse of authority.

3. The financial relief, however, does not include financial reversals (such as credit card fee, annual charges, bank's commission etc.) made by banks/DFIs as per their own policy/industry practices, on regular consumer loans/financing.

4. Before considering/processing of a write off proposal involving principal amount and/or debited mark-up/charges, the banks/DFIs shall adhere to following minimum guidelines:

i.) *Every reasonable effort shall be made to recover the outstanding loan, advance or financing.*

ii.) *It shall be ensured that all liquid securities/collateral held by, and in possession of,* *the bank/DFI have been realized and sale proceeds thereof appropriated towards adjustment of outstanding amount. However, in exceptional cases, such as widows and orphans banks/DFIs may consider relaxation to this requirement under their policy.*

iii.) *The latest valuation not older than one year, of securities and collateral in possession of the bank/DFI and that of fixed assets held as security for the loan, advance or financing shall be obtained at the time of write off of loan advance or financing. The valuation report shall clearly indicate therein, amongst others, the present market value as well as forced sale value. The valuation shall be conducted through an approved valuer on the list of Pakistan Banks Association. For outstanding principal amount of less than Rs. 2 million, valuation may be done by the bank/DFI itself, as deemed appropriate, in a reasonable and transparent manner. Further, for writing off of loan, advance or financing where outstanding amount of principal is below Rs.0.5 million, the requirement of obtaining latest valuation shall not be applicable."*

20. It is, therefore, obvious from the above that a non performing loan remains recoverable till it has been written off in accordance with the above mentioned guidelines issued by the State Bank of Pakistan. The legislature had expressly used the expression 'irrecoverable' under section 23(1)(x) of the repealed Ordinance of 1979. The same expression has been used in section 29 of the

Ordinance of 2001. The expression 'non performing debt or loan' does not find mention in either of the statutes. For the first time the three categories of nonperforming loans i.e 'standard', 'doubtful' and 'loss' were mentioned under clauses (d), (e) and (f) of rule 1 of the Seventh Schedule which was inserted through the Finance Act 2007. The said rules read with section 100 A are not in conflict with section 29 of the Ordinance of 2001. The restricted entitlement to deduction relating to non performing loans classified as 'doubtful' or 'loss' under clause (e) and inadmissibility in the case of 'standard' under clause (d) of rule 1 of the Seventh Schedule affirms that they were not treated as bad debts either under section 23(1)(x) of the Ordinance of 1979 or section 29 of the Ordinance of 2001. Both the said provisions expressly contemplate debts which are irrecoverable. As already noted above, redundancy cannot be attributed to the legislature and, therefore, the crucial expression 'irrecoverable' ought to be given effect and thus interpreted in the case of a financial institution in the context of the regulatory framework which governs the Banks as highlighted above.

21. We therefore hold that, prior to the insertion of section 100 A and the Seventh Schedule in the Ordinance of 2001 through the Finance Act 2007, the entitlement regarding deduction for bad debts was to the extent of irrecoverable loans determined as such under the regulatory framework governing the financial institutions. It did not cover the recoverable loans classified as 'standard', 'doubtful'

and 'loss' which fall within the ambit of the expression 'non performing loans'. The restricted entitlement regarding deduction in respect of nonperforming loans treated as recoverable was for the first time recognized by the inserting of section 100 A and the rules specified under the Seventh Schedule.

C. Concessional Loans Given to Employees.

22. The questions of law formulated for our consideration involve factual controversy. The Banks advance loans to their employees on concessional rates of interest. The respective assessing officers made additions on the basis of the difference between the concessional rate of interest charged to an employee and the prevalent market rate, having regard to section 24(i) of the Ordinance of 1979. This addition was deleted by the learned Tribunal on the sole ground and, after making a determination on the factual side, that no actual expenditure was incurred so as to attract section 24(i) of the Ordinance of 1979. The actual expenditure in relation of concessional loans advanced to the Directors and employees was required to be established by the Department. There is nothing on record to show that the conclusion drawn by the learned Tribunal was based on misreading or non reading. We have carefully gone through the reasoning recorded by the learned Tribunal and feel satisfied that the same does not suffer from any legal infirmity.

23. The questions proposed and listed in Annexure B hereto stand answered in the light of the above discussion. The judgments of the learned Tribunal are, therefore, accordingly modified.

24. A copy of this judgment shall be sent to the learned Tribunal under the seal of this Court as required under sub section (5) of section 133 of the Ordinance of 2001.

(ATHAR MINALLAH)
JUDGE

(MIANGUL HASSAN AURANGZEB)
JUDGE

Announced in the open Court on ***13th March, 2018.***

JUDGE

JUDGE

Luqman Khan/*

Approved for reporting.