

JUDGMENT SHEET.
IN THE ISLAMABAD HIGH COURT,
ISLAMABAD.

Income Tax Reference No.217 of 2011

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

Versus

M/s Zarai Taraqiati Bank Limited.

Applicant's by : Dr. Farhat Zafar, Advocate.

Respondent's by : M/s Muhammad Abu Bakar and Iqbal Hashmi, Advocates.

Date of decision : 04.03.2020.

LUBNA SALEEM PERVEZ, J. Through instant 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 Appellate Tribunal Inland Revenue Islamabad, (*hereinafter referred to "the ATIR"*) in ITA No. 05/IB/11, relating to tax year 2009, whereby, the deletion of addition of post-retirement medical benefits at 50% of the claim and the provision against asset was confirmed.

2. Brief facts of the case are that the taxpayer, a banking company derives income from lending money to the Agriculturist and also from other receipts. The income tax return / deemed assessment order u/s 120(1)(b) of the Ordinance 2001, for the year 2009 was considered to be erroneous and prejudicial to the interest of revenue by the Additional Commissioner Inland Revenue (Audit-II), LTU, Islamabad (*hereinafter referred to as the Assessing Officer*) and was amended under section 122(5A) of the Ordinance, 2001, vide order dated 03.05.2010, while assessing total income of Rs. 393,734,7517/- as against declared income of Rs. 306,987,517/-. The assessed income amongst other additions also included the following provision of expenses with the observation that:-

Provision for employees post-retirement medical benefit

Rs. 1,365,326/-

"It is evident from the above, that one of the conditions of the allowability of the accrued liabilities is that only those accrued liabilities are allowed which are ascertainable, carrying therewith a reasonable degree of accuracy. In the case of the taxpayer accompany the provision/liability under reference cannot be regarded as "ascertainable, carrying therewith a reasonable degree of accuracy for the following reasons:-

- 1. The Medical expenses cannot be determined with accuracy until the patient is discharged from the hospital.*
- 2. The expense which is to be incurred in future cannot be determined with accuracy, as it is impossible to determine with accuracy as to how many persons in a particular year(s), after retirement shall receive the medical care. In such a situation how the future liability can be determined with the reasonable accuracy"*

Provision against Assets

Rs. 337,061,000/-

"Allow-ability of deduction of Rs. 337,061,000/- on account of provision against other asset cannot be allowed as deduction from its income simply for the reason that it is a "mere provision" which in no way is allowable as deduction from income under the Income Tax Ordinance, 2001."

Against the above order, the respondent bank filed appeal before the Commissioner Inland Revenue Appeals-II, Islamabad (*hereinafter referred to as the CIRA*) who vide order No. 167c/2010 dated 12.10.2010 restricted the addition made on account of employee post-retirement medical benefits to the extent of 50% in the light of the decision of the ITAT, for the tax year 2006-2007 vide ITA No. 778 to 781(LB/2010) dated 09.06.2010 and deleted the addition made on account of "provision against assets" in terms of the same decision of the ITAT. The findings of the CIRA are as under:-

Provision for Post-retirement Medical benefit:

The AR pleaded that the addition on this count has wrongly been disallowed and pleaded that the whole amount on this count is admissible. Issue has been examined. However, as the learned ITAT has already adjudicated on the issue in its order for Tax Years 2006 and 2007 as referred earlier as such 50% of the claim is to be allowed.

Provision against asset:-

In this regard the appellant pleaded that the issue has been resolved by ITAT in its decision for Tax years 2006 and 2007 vide Order Nos. 778 to 781/LB/2010 dated 09.06.2010 and the expenses on this account have been allowed. In view of the appellant plea the order of the ITAT has been examined and the addition on this count is directed to be deleted."

The applicant department being aggrieved with the said order filed appeal

before the ATIR who vide consolidated order dated 01.03.2011 dismissed the appeal of the applicant on the above issues by observing as under:-

“As regards the allowance of 50% expenses on account of “Provision for Employees Post-Retirement Medical Benefits”, it is observed that this Tribunal has already endorsed this addition in its earlier judgment, so the action of the CIR (A) to the effect is maintained.

As regards the plea of the revenue that the CIR (A) was not justified in deleting the addition made against “provision against asset”, it is observed that this Tribunal has decided this issue in favor of appellant in its decision for the Tax Year 2006 and 2007 vide order Nos. 778 to 781 dated 09.06.2010, relevant par reproduced while adjudicating the issue in tax year 2008. We fully agree with the earlier decision of the Tribunal and the action of CIR (A) to the effect is maintained”.

Being dissatisfied with the above findings, the applicant department filed present reference application u/s 133(1) of the Income Tax Ordinance, 2001, against the findings given vide decision in ITA No. 05/IB/11, relating to tax year 2009 and referred following questions of law said to arise out of the said order:-

Question 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 the learned Tribunal was justified in allowing the provision against other assets without appreciating that the income tax law does not support the allowance of any such treatment?*

3. Learned counsel for the applicant supported the amended order passed by the Assessing Officer and submitted that restriction of addition to the extent of 50% expense under the head employees post-retirement medical benefits is also unlawful as under the Income Tax Ordinance, expense is allowed when it is actually incurred. Learned counsel submitted that the provision against assets is not an allowable expense as it is a mere provision which have been unlawfully claimed by the respondents and in view thereof, she submitted that the finding of ATIR is not sustainable in law.

4. Conversely, 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 and deleted

addition made by disallowing the provision against assets by relying on its earlier decision which are binding on the ATIR as well as on CIRA. Learned counsel submitted that the provision is based on Actuarial valuation thus is an ascertained liability duly allowable expense under the law.

5. Argument heard and record perused with the able assistance of the learned counsel for the parties.

6. Perusal of the record and order shows that the benefits of post-retirement medical facilities, were granted to the employees and their families by the Respondent. For this purpose the Respondent, on 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.

7. 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 there is any 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.

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 year despite 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. “.

8. 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 an allowable expense even though same are not actually paid during the year.

9. Perusal of the orders passed by CIRA as well as ATIR revealed that both the Appellate Authorities have relied on the following observation of the learned ATIR, whereby, the issues relating to “provision against assets” have been discussed and allowed vide ITA No. 778 to 781(LB/2010) dated 09.06.2010, for the tax year 2006-2007:-

“For the tax year 2006 and 2007, the appellant has claimed an amount of Rs. 1,29,36,000/- and Rs. 2,048,971,000/- in respect of provision against other assets. It was argued that the provision has been made in respect of receivable not received. It has not been claimed over the difference of the claim and the actual receipts. It is further explained that the claim pertain to the defunct ADB which is not yet received by the appellant and is commensurate with the International Accounting Standards. Since it is not the amount which has been earned by the Bank (Appellant), it can be taxed only on receipt. The learned legal Adviser on the other hand refers to a judgment of the said High Court (Income Tax Appeal No. 565 of 2000) wherein, it has been observed that there is no provision in the Income Tax law allowing “Provisions” of Section 29 of the Income Tax ordinance, 2001. The appellant states that this reference is not relevant with the issue in hand. Here the question is only that an amount claimed has not been earned, therefore, no tax can be levied till it is actually received. The arguments of the appellant are weighty and appeal to reason as well. We, therefore, direct that the claim for provision be allowed to appellant.”

10. In view of the above finding, the learned counsel for the applicant was specifically asked as to whether the above decision of ATIR has been assailed before the High Court through reference, however, she was not able to confirm whether any reference has been filed against the above order or not.

11. It is observed that the respondent bank made “provision against other assets” which relates to the claim of certain assets pertaining to the defunct ADB which were not received up to the closure of the tax year. Since, it was not the debt against the amount earned by the Respondent, the

provision was, therefore, made as receivables against assets of the defunct ADB. The ATIR was, therefore, justified in confirming the deletion of addition made by disallowing the provision.

12. For the foregoing reasons, the answer to questions No. 1 & 2 is in **affirmative** in favour of the respondent and against the applicant department. Copy of this order is to 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