JUDGMENT SHEET.

IN THE ISLAMABAD HIGH COURT, ISLAMABAD.

Income Tax Reference No.218 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	:	**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 Appellate Tribunal Inland Revenue Islamabad, *(hereinafter referred to as "the ATIR")* in ITA No. 04/IB/11, relating to tax year 2008, whereby, the deletion of addition of post-retirement medical benefits at 50% of the claim and the provision against asset and the Government Relief package, was confirmed.

2. Brief facts of the case are that the Respondent, 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 2008 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 amended order was passed under section 122(5A) of the Ordinance, 2001, dated 03.05.2010 by assessing the income at Rs. 5,644,913,869/- as against declared income of Rs. 1,826,995,869/-.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. 87151000/-***
>
> *"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. 72,149,000/-***

"Allow-ability of deduction of Rs. 72,149,000/-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.

Government Relief Package written offRs, 567,445,000/-

Looking to the aforementioned facts it is clear that the deduction of Rs. 567,455,000 on account of government's Relief Package Written off is not admissible to the taxpayer company. However, it erroneously stands allowed to it in its assessment finalized u/s 120 for the tax year 2008 consequent to which the government's exchequer sustained a substantial amount of loss of revenue of Rs. 198,609,250 (Rs. 567,455,000 x 35%).".

Against the above order, Respondent filed appeal before the Commissioner Inland Revenue Appeals-II, Islamabad *(hereinafter referred to as the CIRA)* who, vide order No. 168c/2010 dated 12.10.2010, in ITA No. 778 to 781/LB/2010) dated 09.06.2010, deleted the addition made on account of "provision against assets" in terms of decision of the ITAT (ATIR) for the tax year 2006-2007 and restricted the addition made on account of employee post-retirement medical benefits to the extent of 50% of the claim in the light of the same decision. The findings of the CIRA are as under:-

"Provision for Postretirement 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, maintained the findings of the CIRA, and dismissed the appeal of the applicant on the above issues while 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 2007vide order Nos. 778 to 781 dated 09.06.2010". Para 28 of the aforesaid is reproduced below:-

"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 weightily and appeal to reason as well. We, therefore, direct that the claim for provision be allowed to appellant.".

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 finding vide decision in ITA No. 04/IB/11, relating to tax year 2008 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 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?

iii. Whether in the facts and the circumstances of the case the learned Tribunal was justified in allowing the expenses on account of government relief package without fulfillment of condition as per section 29 of the Income Tax Ordinance, 2001?

iv. Whether the impugned judgment of the learned Tribunal is not gross violation of the Apex Court order reported as (2006) 94 Tax 317 (Fatima Sharif Vs CIT) and Sindh High Court in the case of Muhammad UsmanVs CIT?

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 and submitted that the provision is based on Acturial 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 it being a future liability cannot be determined with accuracy.

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 analysed 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 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.".*

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

9. So far as the question No. 2 is concerned, perusal of the orders passed by CIRA as well as ATIR revealed that both the Appellate Authorities have relied on the observations 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.

10. Learned counsel for the applicant was specifically asked that as to whether the above decision of ATIR has been assailed before the High Court through reference or not, however, learned counsel 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 pertained 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 receivable against assets of the defunct ADB. The ATIR was, therefore, justified in confirming the deletion of addition made by disallowing the provision.

12. As regards, the addition made by the Assessing Officer on account of "Government Relief Package" claimed by the respondent company and deleted by the CIRA is concerned, the ATIR while confirming the deletion has observed as under:-

> *"The addition made on account of government relief package amounting to Rs. 3,085,324,000/- has not been adjudicated by the CIR (A), but the learned* ***AR pointed out that this issue has been decided in favour of the taxpayer in tax year 2007 by the Tribunal and the department did not contest the same. The DR also did not agitate the issue and admitted that no further appeal has been filed by the revenue against the said order of the Tribunal****. As it is a settled issue, so we do not feel any hesitation in allowing relief to the assesse on this score and the addition made under this head is deleted.".*

13. The admission of the Departmental Representative, while arguing the case before the Tribunal, that the decision for tax year 2007 in respect of the issue has not been contested further, shows that the claim of "government relief package" have duly been accepted by the applicant department therefore has not been agitated further before this Court.The question proposed needs no deliberation as in view of this acceptance, issue has attained finality.

14. So far as the proposed question No.4 is concerned, perusal of the Appellate Orders of CIRA and ATIR revealed that the judgments of the Hon'ble Supreme Court of Pakistan and the Hon'ble Sindh High Court have not been referred by the Departmental Representative while arguing

the case before ATIR. Thus, this question does not arise out of the impugned order.

15. 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 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