

IN THE SUPREME COURT OF PAKISTAN
(Appellate Jurisdiction)

PRESENT:

Mr. Justice Umar Ata Bandial
Mr. Justice Faisal Arab
Mr. Justice Qazi Muhammad Amin Ahmed

CIVIL APPEAL NO. 573 & 574 OF 2013

(On appeal from the judgment/order dated 06.12.2012 of the High Court of Sindh, Karachi passed in ITR No.517&518/2010)

Commissioner Inland Revenue (Zone-I),
Karachi

Appellant(s)

Versus

M/S Faisal Bank Limited

Respondent(s)

For the appellant(s) : Dr. Farhat Zafar, ASC
Mr. Masood Akhtar,
Chief Legal (FBR)

For the respondent(s) : Mr. Ijaz Ahmed Zahid, ASC

Date of Hearing : 09.03.2020

ORDER

UMAR ATA BANDIAL, J. The impugned judgment of the learned High Court dated 06.12.2012 has reproduced the two questions that were subject to determination in Income Tax References No.517 and 518/2010 pending before it. Speaking generally, these questions require determination of the circumstances when bad debts may be written off by an assessee. The first Tax Reference concerns the assessment year 2001-02 which pertains to the income year ending 31.12.2000. The relevant statutory provision regarding debt

write off in that assessment year is section 23(1)(x) of the Income Tax Ordinance, 1979 ("**repealed Ordinance**"). The second Tax Reference pertains to the tax year 2003 which covers the income year ending 31.12.2002 and involves the interpretation of section 29 of the Income Tax Ordinance, 2001 ("**Ordinance**"). In these matters, the view of the learned Appellate Tribunal was affirmed by the impugned judgment of the learned High Court which held that the bad debts claimed by the respondent-bank fell within the ambit of the afore-noted sections of the two Ordinances to qualify for their write off.

2. Learned counsel for the appellant has made two submissions. First, that the bad debts claimed by the respondent-bank do not satisfy the test of reasonableness that governs the discretion of the Taxing Officer on whether to allow the concession of a write off to an assessee. In this behalf, section 29 of the Ordinance controls the discretion of the Taxing Officer to allow a write off of a claimed bad debt when there are reasonable grounds for believing that such claimed debt is irrecoverable.

3. In the present case, the CIT (Appeals) had vide his order dated 08.11.2005 affirmed the order of the Taxing Officer dated 30.06.2005 to hold that inadequate securities were obtained by the respondent-bank from its two customers in the tax year 2001-02. That the bank had also failed to secure the personal guarantees of the controllers of these

borrower entities. Therefore the bank's claim for write off the alleged bad debts was denied. The second ground taken by the learned counsel for the appellant is that the impugned judgment had improperly held the assessee (respondent-bank) to be "the best judge to determine as to what part of its bad debts required writing off and the assessee cannot write off debts only to save taxes, as in this case, he loses more than he appeared to gain, whereas, the bad debts, if recovered subsequently can be added in the income of assessee." It is claimed that the above formulation construes the rule contained in the aforementioned provisions of the two Ordinances very widely. Rather than requiring the assessee to satisfy the test of reasonableness to demonstrate that the claimed bad debts are actually irrecoverable, undue discretion has been vested in the assessee to select the debt that should be written off.

4. Learned counsel for the respondent has explained the factual position by referring to the order of the CIT (Appeals). It is noted that the respondent-bank paid full amount of Income Tax chargeable on its total recoverable debt of Rs.62.006 million when it provisioned for the said amount during the assessment year 1995-96. As such no revenue loss to the appellant is caused if a part of the said outstanding debt is written off. Secondly, he submits that decrees were obtained against the borrowers owing the said debt and execution proceedings were launched after such decrees

became final. During execution proceedings the judgment debtors settled with the respondent-bank by making a payment of Rs.33 million. As a result, the respondent bank sought write off in respect of the balance of Rs.29 million approximately in the assessment year 2001-02.

5. We note that the legal proceedings were instituted by the respondent-bank against the defaulting borrower which culminated in a decree that attained finality. Thereafter execution proceedings on such decree were launched. As the collateral taken for the loan had been dissipated or the borrower had been arrested, therefore, in such circumstances, the recovery of the full amount of loan became doubtful and a settlement was reached. This matter is essentially concerned with a factual determination about the need for and *bona fides* of the settlement. On this aspect, the view taken by the learned Appellate Tribunal is the final opinion under the law. Be that as it may, in order to satisfy ourselves, we have examined the relevant record. The reasonableness of the determination made by the learned Tribunal is evident from execution proceedings on judicial decrees launched against the defaulting debtors, recovery effected through settlements and the nil revenue implication due to full tax payment for provisioning the claimed amount of bad debts.

6. What remains to be considered is the other question whether the High Court has stated too broadly the test by which debts claimed by an assessee may reasonably be believed as irrecoverable and therefore be

classified as bad debts. It is not a matter of discretion for the assessee to decide what a bad debt is; rather the assessee has to establish reasonable grounds showing that having taken the requisite lawful steps for recovery of the outstanding debts, the same are not recoverable in the foreseeable future. It goes without saying that if in a subsequent tax year recovery of a bad debt is effected then the same is taxable as income. Accordingly, to our minds the test laid down in **Commissioner of Income Tax versus National Bank of Pakistan, Karachi** (PLD 1976 Karachi 1025 at page 1028) that "the question will always be of the estimate of the facts and circumstances of a case, and because human estimates are necessarily fallible, the respondent's claim and/or its books of account cannot be rejected, merely because it maintains a system of accounts, which permits it, in the event of windfall from the debtor, so to say, to reverse the earlier entries writing off a debt as irrecoverable", gives an accurate approach on how the relevant provision, namely, section 29 of the Ordinance, is liable to be construed. Learned counsel for the appellant has referred to the judgment of the learned High Court in **Commissioner of Income Tax (Legal), Islamabad versus Askari Commercial Bank Limited, Rawalpindi** (2018 PTD 1089) which considers the effect of section 100A and the Seventh Schedule to the Ordinance. These were incorporated into the said Ordinance in the year 2007. The following observations were made in relation to the present context:

"The legislature, through the Finance Act, 2007, manifested its intent, inter alia, in relation to the

treatment regarding non performing loans by inserting section 100A 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. ... 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."

7. The facts of the present case pertain to assessment year 2001-02 and tax year 2003 which occurred prior to the year 2007 when the amendments in the Ordinance were made. Therefore the concept of non-performing loan is not quite relevant to the instant case. Be that as it may, the test of reasonableness for justifying irrecoverability of a debt laid down in section 29 of the Ordinance is nevertheless applicable. Therefore, the classification of a bad debt is not left to the discretion of the taxpayer. It must be demonstrated by the securities and the *bona fide* measures taken by the taxpayer to secure repayment of the outstanding debt. To our minds that factual test has been applied and held to be satisfied by the two

learned *fora* below. Accordingly, there are no grounds to interfere with the impugned judgment. These appeals are therefore dismissed. No order as to costs.

Islamabad,
09.03.2020.
Irshad Hussain

~~NOT APPROVED FOR REPORTING.~~