

IN THE SUPREME COURT OF PAKISTAN
(APPELLATE JURISDICTION)

PRESENT:

MR. JUSTICE DOST MUHAMMAD KHAN
MR. JUSTICE QAZI FAEZ ISA
MR. JUSTICE FAISAL ARAB

CIVIL PETITION NOS. 3364 TO 3366, 3517 TO 3519 & 3147-L TO 3149-L OF 2016

(On appeal against the judgment dated 28.04.2016 passed by the Lahore High Court, Lahore in PTR Nos. 69 to 71/2014, 364 to 366/2013, 477 to 482/2015)

Sr. No	Parties' names	Case No.
1.	Husnain Cotex Limited through its Chief Executive Vs. Commissioner Inland Revenue, Lahore	CP Nos. 3364 to 3366 of 2016
2.	M/s Ghulam Rasool and Co. Pvt Ltd. Vs. Commissioner Inland Revenue, Lahore	CP Nos. 3517 to 3519 of 2016
3.	M/s Sarwar & Company (Pvt) Ltd, Lahore Vs. The Appellate Tribunal Inland Revenue etc	CP Nos. 3147-L to 3149-L of 2016

For the Petitioners: Mr. Muhammad Akram Sheikh, Sr. ASC
Mr. Muhammad Iqbal Hashmi, ASC
Mr. Ahmed Nawaz Ch, AOR (Absent)
(In Civil Petition Nos. 3366 & 3517 to 3519/2016)

Mr. Sajid Ijaz Hotiana, ASC
Mr. Ahmed Nawaz Ch, AOR (Absent)
(In Civil Petition No. 3364/2016)

Mr. Muhammad Raheel Kamran, ASC
Mr. Ahmed Nawaz Ch, AOR (Absent)
(In Civil Petition No. 3365/2016)

Rana Muhammad Afzal, ASC
Mr. Imtiaz A. Shoukat, AOR (Absent)
(In Civil Petition Nos. 3147-L to 3149-L/2016)

For the Respondents: Nemo
(In Civil Petition No. 3364/2016)

Hafiz Ahsan Ahmed Khokhar, ASC
Raja Abdul Ghafoor, AOR
(In Civil Petition No. 3365, 3366, 3517 to 3519 & 3147-L to 3149-L/2016)

Date of Hearing: 26.01.2017

JUDGMENT

FAISAL ARAB, J.- In order to grant tax relief to the taxpayers of certain areas of the province of Khyber Pakhtunkhwa, FATA and PATA, whose business suffered on account of internal strife, the government in June, 2010 invoked the provisions of Section 53 of the Income Tax Ordinance, 2001 (hereinafter referred as the Ordinance) under which exemptions or concessions are granted on such incomes or to such persons that are listed in the Second Schedule to the Ordinance. Consequently, Clause 126F was inserted in Part I of the Second Schedule which reads *"Profits and gains derived by a taxpayer located in the most affected and moderately affected areas of Khyber Pakhtunkhwa, FATA and PATA for a period of three years starting from the tax year 2010"*. Thus by virtue of Clause 126F, all profits and gains derived by the taxpayers located in the affected areas stood exempt from income tax for a period of three years.

2. One of the petitioners is a private limited company whereas the remaining two are public limited companies, not listed on the Stock Exchange. They have their business establishments either in Lahore or Multan. As they derive income from executing construction contracts, their business activity, by virtue of Section 153(1) (c) and 153(3) read with Section 169(b) of the Ordinance falls within the domain of 'final tax regime'. Hence the amount deducted at the rate specified in the First Schedule of the Ordinance from the payments made to them towards fulfillment of their contractual obligations are to be treated as their final tax

liability. Accordingly, the petitioners submitted their income tax statements under Section 115 of the Ordinance for each of the tax years 2010, 2011 & 2012 disclosing the deductions made from the payments received against their respective contracts performed in the affected areas. Later it occurred to the petitioners that they were entitled to claim exemption on such payments in terms of Clause 126F, so they applied to the Commissioner for refund of the amounts deducted towards their income tax liability. They initially succeeded in obtaining refund, however, the Additional Commissioner, Inland Revenue issued show cause notices to the petitioners under Section 122(5A) of the Ordinance, proposing to disallow the exemption that was allowed earlier by the Commissioner. After hearing the matter, the Additional Commissioner held that as the petitioners fall within the domain of 'final tax regime' and not under 'normal tax regime', the exemption granted under Clause 126F was not intended for them. This decision was challenged in appeal before the Commissioner Inland Revenue (Appeals-II), Lahore. After his decision in appeal, the aggrieved party assailed the appellate orders before the Appellate Tribunal, Inland Revenue, which held that the petitioners were entitled for exemption. The tax department then filed References before the Lahore High Court which vide impugned judgments reversed the findings of the Tribunal after holding that the petitioners fall within the domain of 'final tax regime' whereas the term 'profits and gains' occurring in Clause 126F was relatable to such taxpayers only who fall within the domain of 'normal tax regime', hence not entitled to claim exemption. Feeling aggrieved

by such decision the petitioners have preferred these petitions for leave to appeal.

3. Mr. Muhammad Akram Sheikh, learned counsel for the petitioners in CPLA Nos. 3366 & 3517 to 3519 of 2016 submitted that the provisions of Section 153(1)(c) and Section 153(3) of the Ordinance are attracted to the case of the petitioners whereby they in each tax year are required to furnish a statement of their income to the Commissioner under Section 115 of the Ordinance and are not obliged to furnish return of income as provided in Section 114 of the Ordinance. He then submitted that irrespective of the fact that petitioners business concerns are located outside the affected areas, as they have executed construction contracts in the affected areas during the exempt years, they were entitled for exemption under Clause 126F. He submitted that accordingly the petitioners furnished a revised statement with the Commissioner under Section 115(4) of the Ordinance and sought refund of the tax deducted at source by the contract awarding entity by invoking Section 170 of the Ordinance. In support of his argument, the counsel for the petitioners referred to Circular No. 14 of 2011 dated 6th October, 2011 issued by Federal Board of Revenue. It interprets the scope of the word 'located' appearing in Clause 126F in order to describe as to which category of taxpayers could avail the benefit of exemption. The relevant portion of this Circular is reproduced below:-

"Government of Pakistan
Revenue Division
Federal Board of Revenue
Inland Revenue Wing

C.No.4(40ITP/2009.PT-I-142122-R Islamabad, 6th October, 2011

Circular No. 14 of 2011
(Income Tax)

Subject: Exemption under Clause (126F) of Part I of Second Schedule to the Income Tax Ordinance, 2001 - Clarifications Regarding

Clause (126F) was inserted in Part I of Second Schedule to the Income Tax Ordinance, 2001, through Finance Act, 2010, to grant fiscal relief to the taxpayers whose businesses were adversely affected during the on-going strife in the Khyber Pakhtunkhwa (KPK), Federally Administered Tribal Areas (FATA), and the Provincially Administered Tribal Areas (PATA), for a period of three years w.e.f. Tax Year 2010. In follow up thereto, a number of communications were issued by the Board to define and clarify the parameters of Clause (126F) including SROs, Circulars, and letters, which being prone to varying interpretations, may have caused certain degree of confusion in some respects.

2. Queries have been received in the Board as regards the availability of exemption under Clause (126F) with reference to the location of the taxpayer, the location of the business, and other allied matters. In supersession of all earlier clarifications issued by the Board, in order to streamline the operation of Clause (126F), and ensure its standardized implementation across the board, the instructions as contained in the succeeding paragraphs will henceforth apply.

3. The word “located” as used in Clause (126F) can possibly have more than one dimension. The relevant scenario along with the corresponding exemption/taxable status are outlined below:-

Sr#	Situation	Exemption/Taxability
(i)	The taxpayer is located inside the affected and moderately affected areas (hereinafter ‘the specified areas’), and his business is also carried on inside the specified areas.	Exempt
(ii)	The taxpayer is located outside the specified areas but his business is carried on within the specified areas.	Exempt
(iii)	The taxpayer is located inside the specified areas, but his business is carried on outside the specified areas.	Taxable
(iv)	The taxpayer is located outside the specified areas, but his business is partly carried on inside the specified areas.	Exempt to the extent of the income attributable to the business operations carried on inside the specified areas.

4. Thus, it is apparent that the provisions of Clause (126F) have to be applied keeping in view the facts of each case.

5. Accordingly, the field formation may decide each case on merit in the light of the above instructions upon filing of a claim in this regard by the taxpayer.

-sd-
(Shahid Mehmood Sheikh)
Secretary-IR (Exemptions/Rules)”

4. In support of his contention, Mr. Muhammad Akram Sheikh also relied upon the judgments reported in the cases of Commissioner of Income Tax Peshawar Vs. Islamic Investment Bank (2016 SCMR 816), Elahi Cotton Mills Ltd. Vs. Federation of Pakistan (PLD 1997 Supreme Court 582), Commissioner of Income Tax Legal Division Vs. Khurshid Ahmad (PLD 2016 Supreme Court 545) and Army Welfare Sugar Mills Ltd. Vs. Federation of Pakistan etc (NLR 1992 Tax 186). The other counsel representing the rest of the petitioners in CPLA Nos. 3364, 3365 and 3147-L to 3149-L of 2016, adopted the same line of arguments that were advanced by Mr. Muhammad Akram Sheikh.

5. Learned counsel for the respondents defended the reasoning given in the impugned judgment by arguing that the concession granted under Clause 126F was only intended for the taxpayers of 'normal tax regime' who were located in affected areas whereas businesses of all the petitioners are located in Punjab and fall within the domain of 'final tax regime', therefore, the benefit of exemption was rightly denied to them. He further submitted that the Circular No.14 of 2011 interpreting the scope of exemption, upon which much reliance was placed by the counsel for the petitioners, was subsequently recalled on 06.10.2011 as it did not depict the true interpretation of Clause 126F.

6. Before examining the applicability of exemption granted under Clause 126F to the case of the petitioners, two types of taxpayers are to be kept in mind. One who fall within the domain of 'normal tax regime', whose net profit in a tax year is

determined by matching costs with the income, after taking into consideration various other factors such as allowances, deductions, depreciations, rebates, amortization etc. The applicable rate of income tax is then applied to the net profit thus arrived at to determine the tax liability of the tax year. The other type of taxpayers are of the petitioners' kind who fall within the domain of 'final tax regime' by virtue of Section 153(1)(c) and 153(3) read with Section 169(b) of the Ordinance. Their income tax liability in a tax year is a certain percentage deducted from the payments which are made to them by the contract awarding entity towards the performance of the contract at a rate specified in the First Schedule to the Ordinance. The income tax that is thus deducted at source fully discharges the contractor from his income tax liability irrespective of what profits and gains he has actually made as the same are of no consideration for the purposes of determining his tax liability.

7. A person who was carrying on business in the affected areas but was unable to sell his goods or services to the extent he used to in normal business environment is the person who can only be described as an affectee of the adverse business environment. It was thus the adverse business environment which directly impacted his business with the result that his profits and gains diminished. The whole stimulus behind the tax exemption granted in 2010 under Clause 126F on the face of it was that sometime in the past the businesses located in the affected areas could not make profits on account of adverse business environment that was being experienced there. So it was purely an external factor that diminished the capacity of the businesses to

make profits and gains that was germane in granting tax exemption under Clause 126F. Hence exemption in question was intended for such taxpayers only. These taxpayers could only be the ones who fall under the 'normal tax regime'. As to the taxpayers who fall under the 'final tax regime', they face no such situation. Firstly, they are not located in the affected areas. They only went to the affected areas when they succeeded in securing contracts, which in itself created business opportunity for them, adverse business environment notwithstanding. Their business activity starts only when they secure contracts. It can very well be imagined that before he submits his bid, he estimates the component of all costs that he is to incur towards the fulfillment of his contractual obligation. To cost he adds his margin of profit. He then adds the income tax liability at the rate specified in the First Schedule to the Ordinance. Where the contract is awarded to be performed in the areas affected by adverse business environment, the same has no impact on contractor's margin of profit which he has already incorporated in the contract price. The contractor is thus not affected by any external factor that is not conducive for doing good business. So the business environment of the area where contract is to be performed doesn't have any correlation with contractor's profit and gains. They, therefore, cannot equate themselves with those taxpayers falling under the domain of 'normal tax regime' whose businesses being located in affected areas suffered financially on account of adverse business environment. While determining the scope of exemption granted under Clause 126F, one should not lose sight of the fact that the precise reason for granting tax relief under Clause 126F was to

ameliorate the financial conditions of certain taxpayers who were real affectees of business environment that had affected their capacity to make profits and gains from their businesses. To extend the benefit of this exemption to the other category of taxpayers who did not even exist in the affected areas before succeeding in obtaining contracts to be performed there could never have been envisioned by the Legislature while incorporating Clause 126F in the Ordinance. We are, therefore, of the considered opinion that in view of the distinction between the two categories of taxpayers discussed above, the taxpayers such as the petitioners who fall under the domain of 'final tax regime' cannot claim exemption under Clause 126F. The case law relied upon by petitioners' counsel, therefore, has no application to the case in hand.

8. As to the legal effect of the Circular No. 14 of 2011, suffice is to state that it was issued with the intention to interpret Clause 126F in a manner so that the benefit of exemption is extended even to such taxpayers also who were located outside the affected areas but they partly did business in the affected areas. In our view this explanatory Circular does not depict the correct interpretation of the scope of Clause 126F as it traveled into altogether a different direction from what we have discussed hereinabove. It appears that ultimately better sense prevailed with the Federal Board of Revenue as we were informed by learned counsel for the department that Circular No. 14 of 2011 was subsequently withdrawn vide letter dated 07.06.2013.

9. In addition to what has been discussed above, it may also be mentioned here that in terms of clause (e) of Sub-Section (2) of Section 169, no refund of the tax deducted from the payments made to the taxpayers falling under 'final tax regime' can be claimed if the same have been deducted at the rate chargeable under the provisions of the Ordinance. Therefore, the petitioners being taxpayers who fall within the domain of 'final tax regime' could not have claimed refund of the deducted tax even otherwise as it is not their case that the deductions were made at the rate higher than the rate specified in the Second Schedule of the Ordinance.

10. We, therefore, conclude that the tax exemption granted in the year 2010 under Clause 126F from its tenor could only have been intended for the taxpayers falling under the domain of 'normal tax regime' whose profitability while doing business in the affected areas had diminished in the past on account of an external factor i.e. political strife that affected the profitability of doing business there. The exemption was never meant for the taxpayers like the petitioners whose businesses fall within the domain of 'final tax regime' for whom the question of experiencing loss of business opportunity on account of internal strife does not arise. They made their presence in the affected area only when they had in their hands a business opportunity to make profits and gains in the form of contracts to be executed there. The income tax department shall accordingly proceed to recover the income tax that has been wrongly refunded to any of the petitioners.

11. We vide short order dated 26.01.2017 dismissed these nine petitions and the above are the detailed reasons for the same.

JUDGE

JUDGE

JUDGE

Islamabad, the
26th of January, 2017
Approved For Reporting
Khurram.