ITBAK's News & Views

April To June, 2004

NV # 03/2004

A monthly publication of the Income Tax Bar Association, Karachi covering information on recent important judicial pronouncements, circulars and clarifications

Contents

Income Tax Bar Association Karachi, Bar Chambers, New Income Tax Building, Shahra-e-Kamal Ataturk, Karachi. – Tel: 9211792 – Email: itbarkhi@cyber.net.pk

IMPORTANT CIRCULARS AND NOTIFICATIONS

CIRCULARS/ NOTIFICATIONS REFERENCE	DATE	ISSUES INVOLVED	ITBAK LIBRARY REF: NO.
		INCOME TAX	
SRO 209(I)/2004	08.04.2004	CBR has constituted a Committee under Rule 213A read with S.206A, for purposes of giving Advance Ruling to Non-Residents, comprising Chairman, CBR as its Chairman and Member (Direct Taxes), CBR and a nominee of Law Division Mr. Zakir Mahmood Janhar, Senior Joint Secretary, Ministry of Law, Justice and Human Rights, as its members.	14
SRO 236(1)/2004	24.04.2004	Agreement signed for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income, by the Government of Islamic Republic of Iran and Government of Pakistan, provisions of which will come in effect from 01.01.2005.	15
C.No.7(1)S(ITAS)/2004	04.05.2004	Guidelines for Tax Audit of Corporate Returns for Tax Year 2003, issued by CBR to all RCITS.	16
C.No.7(13)S(ITAS)/2004	04.05.2004	Guidelines for Tax Audit of Non- Corporate Returns for Tax Year 2003, issued by CBR to all RCITS.	17
Press Release No.(1)S/(ITAS)/04	13.05.2004	Parameters for selection of Corporate and Non-Corporate cases for audit for Tax Year 2003, released by CBR in press.	18
C.No.1(1)Chief/(USA S/03	21.05.2004	CBR clarified that as per policy decision, no correspondence will be made by the Department with the Tax Payer, in respect of Returns filed under USAS, for Tax Year 2003. Further, letters already issued for removal of deficiencies and filing of short documents should now not be pursued, and in case of violation of these instructions, strict action shall be taken by CBR.	19
Circular No.2	25.05.2004	Instructions regarding payment of Advance Tax Liability u/s. 147 of the Income Tax Ordinance, 2001 issued.	20
		COMPANY LAW	
Circular No.15	02-04-2004	To facilitate the clients/customers of Non Banking Finance Companies (NBFCs), it has been decided that in cases where the depositors/borrowers have not yet obtained Computerized National Identity Cards (CNIC) for opening of accounts/ extension of financing, the NBFCs, may obtain the attested copies of old NIC and receipt of NADRA (evidencing that the client has applied for CNIC) along with an undertaking that a copy of CNIC will be submitted immediately on receipt.	21
Circular No.16	02-04-2004	Similar clarification regarding validity of old NICs has also been issued in case of Modarabas, as in case of NBFCs, as discussed above.	22

CIRCULARS/ NOTIFICATIONS REFERENCE	DATE	ISSUES INVOLVED	ITBAK LIBRARY REF: NO.
Circular No.17	06-04-2004	In order to maintain discipline in data reporting by NBFCs to the Credit Information Bureau (CIB) of SBP, all NBFCs are directed in terms of S.282(1) of the Companies Ordinance, 1984 to provide factual and accurate data to SBP on the prescribed format, from time to time, on monthly basis, but not later than 10th of every month following the month to which CIB data relates.	23
Circular No.18	06-04-2004	Similar directives to the above effect, have also been issued to Modarabas for submission of monthly data to Credit Information Bureau (CIB) of SBP. It has also been observed that any violation in this regard shall be dealt under the provisions of the Modaraba Companies and Modaraba (Floatation and Control) Ordinance, 1980.	24
Circular No.19	14-04-2004	Listed Companies have been allowed to place its Quarterly Accounts on its website which will be treated compliance of the provisions of S.245 of the Companies Ordinance, 1984, subject to the fulfillment of the specified conditions.	25
Circular No.20 .	14-04-2004	Directives issued under Rule-7 of Credit Rating Companies Rules, 1995 that while entering into a rating contract, the credit rating companies shall not accept a rating assignment where a client terminated a rating contract with another credit rating company, except with the prior approval of the SECP, and communicating in writing with the credit rating company, if any, which had previously rated the company, to ascertain professional reason as to why the appointment should not be accepted.	26
SRO 161(I)/2004	17-03-2004	In suppression of earlier notifications, SECP notified Powers and Functions of Director (Enforcement Department) Company Law Division to adjudge all offences, contravention's and defaults under various specified provisions of the Companies Ordinance and to impose fine (other than fine in addition to, or in lieu of, imprisonment).	27
SRO 162(I)/2004	17-03-2004	Powers and Functions under various provisions delegated by SECP to its Commissioners and Officers, subject to such conditions and limitations, as it may impose, from time to time.	28
Press Release		Appointment of Corporate Ombudsman is under way, as a part of the administrative set-up of the SECP.	29
Press Release		Lahore High Court Single Bench has suspended the ruling of the SECP on the change of the external Auditors after 5-years by the Listed Companies and rotation the Partner-in-charge of the audit engagement.	30
Press Release		"Directors and Secretaries Guide" booklet has been launched by the SECP.	31

CIRCULARS/ NOTIFICATIONS REFERENCE	DATE	ISSUES INVOLVED	ITBAK LIBRARY REF: NO.
		SALES TAX	
Circular No.1/04	20-04-2004	To mitigate the hardship of tax-payers, CBR exercising power under S.74 has condoned the delay of 60-days for payment in terms of S.73 beyond the prescribed period of 120-days, subject to fulfillment of specified conditions, without any prior verification/certification of sales-tax official, as such verification will be done at the time of audit. However, in case of delay beyond 60-days, the condonation will operate only when the Collector, after examining the case, is satisfied that the delay was genuine and due to circumstances beyond the control of the applicant.	32
SRO 246(1)/04	05.05.2004	Amnesty/Exemption allowed of Sales-tax, Additional Tax and Penalty, to various Retailers, on fulfillment of specified qualifying conditions by 20.06.2004.	33
SRO 247(1)/04	05.05.2004	Amnesty/Exemption allowed in respect of Additional Tax and Penalty, to various Registered Persons, on fulfillment of specified qualifying conditions by 20.06.2004.	34
SRO 335(1)/04	24.05.2004	Repayment of Refund of Sales-Tax to the extent of 10.5% of amount of tax, per metric ton on Oil Seeds, paid at the Import Stage allowed to the solvent Extractors on fulfillment of specified conditions.	35

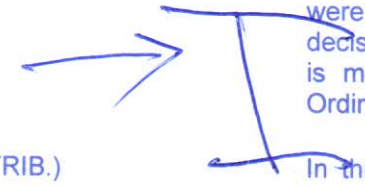
SYNOPSIS OF IMPORTANT CASE LAW

INCOME TAX

CITATION	SECTION	ISSUES INVOLVED
(2004) 89 Tax 302 H.C LAHORE		The Hon'ble Lahore High Court has held that whether return filed by the assessee qualified for acceptance or not under the Self Assessment Scheme is a Question of fact.
(2004) 89 Tax 315 HC PESHAWAR		In this case, the Hon'ble court has observed that since the provisions of Income Tax Ordinance, 1979 were not applicable to the Tribal Areas as envisaged under Article 247, deduction of Tax from regular income certificates in Tribal Areas was illegal. The Hon'ble Court was pleased to declare that the deductions made from the certificates issued by National Saving Centres at Mengora were illegal and the said Centre was directed to reverse the entries of deduction of withholding tax and the amount so far deducted shall be credited to the account of customers.
2004 PTD (TRIB.) 1029		In this case, the department had taxed the receipts of the assessee which were received through a contract of services under section 80C. The assessee filed an appeal before the learned Tribunal directly since the orders were passed under section 66A. The Hon'ble Tribunal after examining the various aspects of the case held that the services rendered whether through a contract or otherwise are not covered by the Presumptive Tax Regime as laid

even WHT is illegal.

in section 80C. It was further held that restricted meaning cannot be given to the expression "services". The action of cancellation of assessments by resorting to section 66A was held to be unsustainable in law and appeals were allowed. The worthy members are requested to carefully read this decision which is of great significance in view of the fact that the Department is misconstruing the expression "services" even under the Income Tax Ordinance, 2001.



2004 PTD (TRIB.) 1038

In this case, assessee filed the return for the assessment year 1998- 99 under Self-Assessment Scheme, which was excluded from normal law assessment for the reason that the assessee had included the deemed income for the purpose of comparison. However, assessee's case was excluded on the basis of subsequent clarification by CBR in Circular letter dated 16.9.1998. The learned Tribunal, after examining the facts of the case and judgments of the superior courts held that since the Self-Assessment Scheme clearly provided for inclusion of deemed income for the purposes of comparison, that provision cannot be withdrawn by CBR by issuing clarificatory circular letter. It was, therefore, held by the learned Tribunal that assessee had rightly taken into account the deemed income under section 80C for the purpose of comparison and his case qualifies under Self-Assessment Scheme

2004 PTD (TRIB.) 1052

In this case, the assessee's assessment was reopened u/s 65 on the ground that investment made was un-explainable. The Assessing Officer had partially accepted the source of investment, however, the investment not fully explained was thus added in the income. The CIT(A) had set aside the assessment. The assessee preferred appeal against Order of CIT(A).The learned Judicial Member after examining the facts held that notice u/s 65 was invalid since there was no definite information. Secondly, he also accepted the plea of the assessee that since the assessing officer had not ticked the relevant clause of section 65 while issuing notice, the reassessment was illegal. He, therefore, cancelled/annulled the assessment. The learned Accountant Member disagreed with the learned Judicial Member on the ground that since the CIT(A) had not adjudicated the issue despite the fact that issue of reopening was challenged. The learned Accountant Member, therefore, maintained the set aside order of CIT(A). The matter was referred to the Third Member due to difference of opinion. The question for resolution of issue was; "Whether the learned Judicial Member is justified to annul the assessment of the DCIT on the issue of non-justification of action under section 65 when this issue does not arise from the appellate order of the Commissioner, which has been impugned by the assessee before the ITAT"? The learned Third Member after examining the scope of the question and relevant law held that even if there is no finding by the CIT)A) and the matter relates to a legal question specifically that of jurisdiction it can be raised and decided by the court hearing the appeal. He further held that where it is established that requirements of law are not fulfilled, the decision is always of cancellation or annulment. He, therefore, agreed with the learned Judicial Member and annulled the assessment

2004 PTD (TRIB) 1062

In this case, provisions of section 66A were invoked to make addition u/s 12(9A) . The Hon'ble Tribunal after examining the provisions of Section 12(9A), CBR's letter dated 8.6.2001 and 16.6.2001 and relying upon the decision of similar nature in ITA No. 2256 and 223/KB held that for the purpose of Section 12(9A), 40% of after tax profit are to be computed on the basis of assessee" after tax profit as declared in the final accounts and not on the basis of its assessed profits as the term after tax profits refers to profits computed in accordance with the generally accepted and understood

accounting principles and standards. It was further held that the IAC has jurisdiction to examine and verify the genuineness of the assessment order to arrive at "after tax profits" of assessee, however, order u/s 66A imposing tax u/s 12(9A) on the basis of assessment of the relevant period is apparently unjustified. The IAC was directed to compute the after tax profit in accordance with the generally accepted and understood accounting principles after verifying the genuineness of various deductions claimed by the assessee to arrive at its "after tax profit".

2004 PTD TRIB 1096

In this case, the learned ITAT has reiterated the principle that Action u/s 52 cannot be taken on assumptions and guess work. It was further observed that it is important to point out here that the provisions of section 52 are different from the provisions of section 62 under which the Assessing Officer required to determine the income and to charge tax thereon. In the case of section 52, the assessee being a `payer' has been made liable for deduction of tax on behalf of the department not being his liability. He is required to perform the function of department as a withholding agent for which he is not rewarded or compensated in any manner. The assessee as a `payer' has to perform extra work for deduction of tax which is to be deposited in the treasury following with the submission of monthly as well as annul statement. The tax under section 50(4) is to be deducted by a withholding agent at the time of making any payment on account of supply of goods, service rendered to or execution of contracts. In the case the hon'ble Tribunal found that the Assessing Officer failed to point out any such payment liable to deduction of tax under section 50(4) of the Ordinance.

2004 PTD TRIB 1115

In this case, the learned ITAT has held that limitation for invoking action u/s 66A on a issue which was not subject matter of appeal will be governed from the Original assessment u/s 62. Thus, it was held that assessment could not be revised beyond the period of four years.

2004 PTD 1123 H.C LAHORE

In this case the Hon'ble Court has held that assessee on whose instance the questions have been referred is absent, the Court is not bound to answer the questions referred to it

2004 PTD 1173 H.C KARACHI

In this case, action under section 66-A was initiated which was challenged by the Petitioner before learned ITAT which was allowed. The appeal preferred by the department was also not allowed by the Hon'ble High Court. Thereafter, appeal was filed before the Hon'ble Supreme Court by the department which was disposed of in the terms that orders of learned ITAT were set aside. The IAC was directed to serve a notice upon the Petitioner u/s 29 for explanation in respect of Capital Gain. After the remand, case was taken up by the IAC which was subsequently withdrawn. Fresh notice was issued by the Commissioner, which was replied by the Petitioner and order was passed imposing tax liability u/s 27.The Petitioner challenged the action and argued that u/s 239(4)of the Income Tax Ordinance, 2001 the pending proceedings were required to be dealt with in accordance with the provisions contained in the repealed Ordinance, as if the Income Tax Ordinance, 2001 has not come into force and therefore, the proceedings under section 66-A of the repealed Income Tax Ordinance, were required to be completed by the IAC and the order passed by the Commissioner is without jurisdiction. It was however not denied by the Petitioner that the matter has been decided by the Commissioner, in accordance with the provisions contained in section 27 of the repealed Ordinance. It was, therefore observed by the Hon'ble Court that there is no objection on the point of applicability of the substantive law and the sole objection is directed on the point of procedural law and the jurisdiction. On the other hand, the learned counsel for the department

Submitted that subsection 4 of section 239 relied upon by the Learned counsel for the petitioner is to be read with subsections (1) and (2) of the said section. He submitted that on a combined reading of all the above three subsections, the legal position which emerges is that the assessment in respect of any income year ending on or before the 30th of June, 2002 and proceedings pending under the repealed Ordinance, on the commencement of Income Tax Ordinance, 2001 are to be dealt with in accordance with the provisions of the repealed Ordinance, meaning thereby that the substantive as well as procedural law shall be applied as contained in the repealed Ordinance. However, the jurisdiction shall be exercised by an income tax authority, which is competent under the Income Tax Ordinance, 2001, but in accordance with the procedure specified in the repealed Ordinance. He further pointed out that under the repealed Income Tax Ordinance, the various income-tax authorities, subordinate to the C.B R. and Regional Commissioner of Income Tax were conferred with their Independent jurisdiction under the statute and were empowered to exercise the same. However, under the scheme of law contained in the Income Tax Ordinance, 2001, a total departure has been made from the earlier scheme and the pivotal position in the Execution of income tax law is occupied by the Commissioner, in whom all the powers are vested. The Commissioner may exercise all or any of the powers as Commissioner of Income Tax or a Taxation Officer which includes Inspecting Additional Commissioner or may delegate all or any of his powers to any Taxation Officer. In the absence of delegation of power by the Commissioner under section 210 of the Income Tax Ordinance, 2001, any Taxation Officer including IAC cannot exercise independent jurisdiction on its own. In support of this contention, reference was made to the definition, of Commissioner contained in section 2(13) of the Income Tax Ordinance, 2001, and the definition of Taxation Officer as contained in section 2(65). It was submitted that by virtue of the provisions contained in sections referred to above, the Commissioner has decided the case in accordance with the provisions contained in the repealed Ordinance and thus, the remand order of the Hon'ble Supreme Court has been complied with in letter and spirit in accordance with the provisions of law as prevailing for the time being in force. He has maintained that the petitioner has already preferred an appeal before the Income Tax Appellate Tribunal, which is pending, and he may pursue his remedy before the Tribunal. It was argued that the petitioner is misconceived, which is liable to be dismissed.

The Hon'ble Court after examing the relevant provisions of law held that, in order to arrive at the correct conclusion, a scheme of law is to be examined in its totality and no provision of law is to be considered in isolation. It was observed that that all the pending matters at the time of commencement of Income Tax Ordinance, 2001 are required to be decided in accordance with the provisions contained in the repealed Ordinance, but by an income tax authority competent under the Income Tax Ordinance, 2001. In the context of the facts and law involved in this case, the Income Tax Authority competent under the Income Tax Ordinance, 2001, to exercise the power of IAC is the Commissioner of Income Tax. Although he is empowered to delegate his authority to an IAC but the non-delegation of power to IAC cannot be objected to, as it is within the discretion of Commissioner of Income Tax and when a discretion in law is exercised by competent authority, it is not open to any exception. It was, therefore, held that the Commissioner of Income Tax has complied with direction of Hon'ble Supreme Court in accordance with law and has passed the order u/s 66-A of the repealed Ordinance, in accordance with the substantive law contained in the said Ordinance in the capacity of IAC. Such order is open to appeal before the Income Tax Appellate Tribunal, where the appeal has been preferred and is pending, The Income Tax Appellate Tribunal shall decide the appeal on merits in accordance with law.

The impugned order passed by the Commissioner, does not suffer from any lack of jurisdiction.

2004PTD1263
H.C LAHORE

In this case, the accounts of the assessee were rejected without pointing out deficiencies in the books of account. The Hon'ble Court has held that that the learned Tribunal was not justified in restoring the additions as no deficiency was pointed out in the books maintained by the assessee. It was further observed that the appellant is correct in pointing out that loss due to drayage was a normal and unavoidable feature of the manufacturing process and that the same could be verified from the quantitative details of the cotton purchased, consumed and the yarn manufactured given in the record maintained

2004 PTD (TRIB) 1225

In this case, the Hon'ble Tribunal has observed that it is also imperative to mention here that in all cases where version of taxpayers is not accepted, the penalty proceedings shall not be attracted, ipso facto although the rejection of taxpayer version may justify the addition to be made in total income. In no way a reasonable difference of opinion on the point of law or principle of accountancy shall attract imposition of penalty.

(2004) 89 TAX 342 TRIB

In this case, question arose for interpretation of Section 12(9A) of the Income Tax Ordinance, 1979. There was difference of opinion between the two members of the Hon'ble Tribunal on the issue, the matter was referred to Third Member, As per the question posed for the opinion of the third member the issue was that whether the reserves of the assessee company for the purpose of sub-section (9A) of section 12 of the Ordinance are to be quantified from the date of enactment of said section or from the inception of the company? In the learned Third Member observed that in his considered opinion, the `reserves' for the purpose of sub-section (9A) of section 12 are to be taken as the excess of undivided profit earned during `a year'. It was observed that the meanings of words `reserves' used in sub-section 9-A of section 12 as the excess of the amount remaining undivided out of the profit earned during a particular year which does not mean to include the reserves of earlier years also. It was observed that the perusal of Section reveals that subsection 9-A of section 12 of the Ordinance is applicable in the case where:

(I) the profit is derived by a public company for any income year,

(II) cash dividends are not distributed within seven months of the end of the said income year or the undivided profit for that year is in excess of 50% of its paid up capital;

(III) The `reserves' of the company are in excess of 50% of its paid up capital; and

(IV) The profit to be considered for the purpose of sub section 9-A is the profit for the year underconsideration only.

It was further observed that when the above ingredients of the sub-section (9A) are taken up jointly and considered in their entirety is becomes easier to interpret the term reserves' appearing in the said sub-section (9A). The most plausible interpretation of the term `reserves' used in the abovementioned sub-section (9A) it means the amount being the undivided profit of the relevant year only and does not include the brought forward `reserves' of the previous years. Even otherwise, It Is sct plausible to include the brought forward reserves of previous years in the undivided profit of a subsequent year for the purposes of sub-section (9A) of section 12 because in such a

case the same amount shall be again and again charged to tax under the same provision which is not permissible under the law. The definition of word 'reserves' provided in rule 203-AA of Income Tax Rules. 1982 is also not exhaustive and does not provide a direct answer to the question under consideration. Since it is a settled principle of law that in case oJ fiscal statute where more than one interpretation of a provision is possible then one favoring the assessee is to be followed. Under thc circumstances, it is held that the `reserves' for the purpose of sub-section 9A supra is the amount of undivided profit of the relevant year only and it does not include the brought forward reserves of the previous years.

2004 PTD (TRIB) 1688

In this case, the Commissioner of Appeals had annulled the assessment for the reason that notice u/s 61 was not served. The department challenged the finding before the learned Tribunal. The learned Tribunal examined the various provisions of law and observed that section 61 speaks about adherence of a certain procedure to be followed prior to formulation of the assessment and notice relating to the procedure and any uncertainty or deficiency tantamount to procedural deficiency. Such deficiency can be cured by issuing a fresh notice. The order of Commissioner of Appeals was vacated and assessment was set aside for de novo assessment in accordance with law. It was also observed that where the legislature has prescribed to followed certain procedure consequent upon which a tax liability would be created, in such circumstances non compliance thereof certainly renders the order to have been made ab-initio illegal and void. Reason being such eventually falls with the parameter of substantive Giving examples, it was further obverse that non confrontation of the assessee u/s 13(2) while making addition u/s 13 or improper service of a statutory notice issued u/s 65 boils down to the impugned addition or re-assessment framed u/s 65 to have been made without lawful authority. Reason being issuance of notice u/s 13 or proper service of statutory notice u/s 65 is the mandatory requirement of law and non observance thereof would be fatal.

2004 PTD (TRIB) 1682

In this case addition u/s 13(1)(d) was made which was deleted by the first Appellate authority. The department challenged the finding before the Hon'ble Tribunal. The Hon'ble Tribunal after examing the facts and relevant law reiterated that addition u/s 13(1)(d) cannot be made as Registered Sale deed outright could be rejected with regard to the sale price entered therein except when rebutted by a cogent evidence by establishing that the assessee expended more amount than the sale price shown. It was further observed that when there was no evidence to disprove the sale price mentioned in the registered deed which being a public document had presumption of truth, same could not be rejected on mere assumptions or conjectures and surmises.

(2004) 89 TAX 461 TRIB

In this case of a Bank, a Full bench was constituted due to two conflicting judgments on the point of exemption for the income from branch situated at Karachi Export Processing Zone. The Hon'ble Tribunal held after examing the relevant statutory provisions that exemption was not available to the Banks for the reason that firstly the exemption was for industrial undertaking and secondly that there was no certification from the Federal Government for bringing the services within the purview of industrial undertaking.

2004 PTD (TRIB) 1655

In this case, ITAT during examination of the amendment made through Finance Act, 1991 in Rule 7 of the Third Schedule to the Income Tax Ordinance, 1979 held by the Hon'ble Tribunal that amendment creating a charge is prospective in nature, it was further held that retrospectively could be presumed in respect of a statute.

2004 PTD (TRIB) 1642

In this case, the basis used for estimation of sales by the inspection was found to be without any evidence and material. The learned Tribunal disapproved such estimate.

2004 PTD (TRIB) 1602

In this case, being a case of Insurance Company, the learned Tribunal after relying on the judgment of Hon'ble Supreme Court has held that Capital Gains arising on sale of shares are chargeable to tax at 25%. However, the additions made in respect of Provision for taxation, deduction of tax deducted at source and disallowance of provision of diminution in the value of investments was held to be proper.

2004 PTD (TRIB) 1593

In this case it has been decided on the basis of two judgments of Hon'ble Lahore High Court that action u/s 65 could not be initiated when the asseseee had not filed return of the year nor any assessment had been made for such year for which notice u/s 65 was issued.

2004 PTD (TRIB) 1572

In this case, the learned Tribunal has reiterated that addition u/s 12(18) can only be made when loan is claimed or shown to have been received. It has been further held that provision of Section 12(18) was introduced to tax the fictitious loans shown by certain taxpayers to avoid incidence of tax.

2004 PTD (TRIB) 1562

In this case, the assesee a company declared income for the year and thereafter adjusted the brought forward losses and paid the tax higher than the preceding year. The return was therefore filed under Self Assessment Scheme. The returns were not considered under the self Assessment scheme and assessment was framed under normal law. The appeal of the assesee succeeded before the first appellate authority, where contention was raised that under the Scheme it merely required the declaration of Income and not total income.. The department challenged the order before the learned Tribunal and it was argued that since assessee has shown loss its return did not qualified for Self Assessment. The learned Tribunal after examining the provision of Ordinance and Scheme held that contention of the assessee is in correct and order of CIT(A) was vacated and Assessments framed by the DCIT were restored.

2004 PTD (TRIB) 1499

In this case a private limited company an internet Service Provider (ISP) claimed First year Allowance under Rule 5A of the Third Schedule, which was rejected for the reason that since assessee was not an Industrial undertaking, the claim was disallowed. The learned Tribunal after examine Rule 5A held that it indicates that the First Year Allowance is available apart from manufacturers to other industries including service, infrastructure, social and agricultural sectors. It was further observed that definition of Industrial Undertaking as provided in the First Schedule is not applicable. It was held that assessee was entitled to the allowance as given in Rule 5A of the Third Schedule.

2004 PTD (TRIB) 1470

In this case the return of income was filed under Self Assessment Scheme, which was set apart for normal assessment as according to the assessing officer income was shown far below from the last assessed income where the condition precedent laid down in the Scheme was that it should have been at least 20% more than the last assessed income. The assessee challenged the exclusion before the CIT(A) which was rejected. In second appeal before the learned Tribunal it was argued that according to the relevant scheme vide Circular No. 4 of 2001 it was provided that condition regarding increase in tax shall not be applicable if income consists of or includes salary and such income constitutes more that 50% of the total income declared for the year

.The learned Tribunal after examing the facts and relevant provision accepted the contention of the assessee and consequently the assessing Officer was directed to accept the claim of the assessee under Self Assessment Scheme.

2004 PTD (TRIB) 1396

In this case, the addition u/s.13(1)(d) was made without obtaining approvals and on the basis of parallel properties. The learned Tribunal after examing the case on facts and law held that approvals were not obtained and that basis of parallel cases are simply reason to suspect as there was nothing on record to prove that any consideration which is over and above what has been recorded in the registered Deed has been ever passed on to the seller from the buyer. It has been further observed that Rule 207A in view of judgment of Hon'ble Lahore High Court is remedial and retrospective. Addition therefore was deleted.

2004 PTD (TRIB) 1391

In this case addition u/s 13 (1)(aa) were made, which were contested to be without proper service. The learned CIT(A) set-aside the assessment. On further appeal to the learned Tribunal, the contention was raised that learned CIT(A) should have cancelled/ annulled the assessment once it was found that service was not proper. The learned Tribunal observed that the question for determination is to whether the service of short document notice upon the servant of the assessee could be regarded as proper service on the assessee or not. It was observed by the learned Tribunal that proposition can be easily answered by resorting to the provisions of section 154 regarding service of notice prescribing for service either by post or in the manner provided for service of a summons issued by a Court under the Code of Civil Procedure. The service of notice on the servant of an assessee cannot be regarded as a proper or valid service because other than service by post the service can be made firstly on the assessee in person or upon his agent empowered/ authorized to accept service and in his absence then upon an adult male member of the family of the assessee. The learned Tribunal relying on the Judgment of Hon'ble Supreme Court of Pakistan reported as (1967) 15 Tax 103 and judgment of Hon'ble Karachi High Court reported as (1961) 3 Tax 68, held service invalid and illegal and accepted the contention of the assessee that assessment should be cancelled/annulled.

DECISIONS OF SECURITIES AND EXCHANGE COMMISSION OF PAKISTAN

No and Date of Judgment	Section of Co. Ord.	Defaults/Issues involved	Decision/Judgment
21-1-2004 Appeal No. 60 of 2003	S.158(1) S.245 & S.246	Defaults in holding AGM and in transmitting half yearly accounts and quarterly accounts	Company's contentions rejected that circumstances were beyond control, due to heavy financial losses, shortage of working capital and non operation of the manufacturing activities of the company, and as such, default was termed as willful and intentional. Chief Executive was fined Rs. 65,000, and other Directors were issued a strict warning to be careful in future.
07-1-2004	S.158(1) S.245 & S.246	Default in holding AGM and transmitting of half yearly accounts and quarterly accounts	Company's contention that the default in preparation and finalization of the annual accounts of the previous years was of the auditors was rejected and fine of Rs.10,000 for each of the three defaults of not holding AGM and preparation and transmission of both half-yearly and quarterly accounts were imposed.

		Default in Transferring of Shares, although Transfer Deeds Lodged were valid.	Valid transfer deeds were lodged by the appellant and the respondent resisted in transferring the shares. Held that the company prolonged this issue of transfer of shares on one pretext or the other and the directors might have some interest in not transferring the Shares lodged by the purchasers, because there was no defect or invalidity in the instruments of transfer lodged. Held that since the Company has not been able to justify the delay in transfer of shares, has therefore, committed default and were directed to transfer the shares within 15 days of the order and report compliance to the commission. Non-compliance of the same would render the Chief Executive and Director punishable under section 495 of the Ordinance.
20-02-04	S.158(1) S.233(1)	Default for not holding AGM and submitting Annual Accounts	Company pleaded that due to recent changes in the law for holding early AGM and due to other unavoidable circumstances the company could not hold the said AGM within time. The contention was rejected and the Chief Executive was penalized for Rs.20,000 for non-holding of AGM. However, proceedings for not filing audited accounts were dropped as company has subsequently submitted the annual accounts in response to the show cause notice.
25-02-04	S.208(3)	The Company made investment aggregating Rs.96,157,774 in its associated undertakings, without seeking prior approval of the members, whereby violated provisions of S.208.	Company's contentions that said investments were made when the associated companies were facing financial constraints and this investment has not caused any revenue loss to the Company, and members approval could not be obtained due to inadvertent omission and was unintentional. However, the Company has subsequently made recovery of the amount due from associate concern alongwith markup thereon, and has also given notice for return of balance amount due along with markup. The Commissioner after considering the confessional statement of the Directors and the perusal of the documents and information placed on record held that the investment was made in the associated undertaking without passing Special Resolution by its shareholders, as required u/s. 208, which has also been reported in the auditors' report and in the directors' report. Therefore, the Chief Executive and the Directors have violated the provisions of Section 208 and have not exercised due care while providing advances to associated concerns, but have admitted the default, and have promptly acted and is in a process of rectifying the default by recovering the balance due from its associated companies with interest over and above their borrowing cost and have also assured that they would ensure strict compliance in future. Therefore, a lenient view was taken and a fine of Rs. 25,000/- each on the responsible directors were imposed. Further the Chief Executive and directors were directed to recover the entire

			outstanding amount along with markup thereon from the associated undertakings within four months and an auditor certificate confirming the total recovery of the amount from the associated undertakings shall be furnished to the Commission thereon.
03.03.04	S.265	Notice issued that the accumulated losses has exceeded the equity and its current liabilities exceed its current assets by huge amount, hence the financial position of the Company endanger its solvency and the statements also revealed inconsistencies in the operating results of the Company. Further the Company has also not declare any dividend for the last several years.	The company contended that the whole industry has gone into the recession and due to adverse financial position, the company has to utilize its capital, it was also revealed that the auditors have expressed their disclaimer in their report, as books of accounts and underlying records were not provided by the Company. Further, due to several irregularities by the previous management and employees a detailed investigation in this regard is required. The new management would also bear the cost of this investigation, if undertaken. Commissioner, in exercise of the powers conferred appointed a Chartered Accountants to act as Inspector on a remuneration of Rs.100,000/- (Rupees One Hundred Thousand Only) to be paid by the new company management.
11-03-04	S.245(3)	Delay in preparing and transmitting quarterly accounts by 67 days.	Contention of the Company that the delay in finalization of the annual accounts for year ended 30th June, 2003, for which company was even allowed extension for holding AGM upto 23.12.2003, resulted in consequential delay of quarterly accounts, was held as not a justifiable excuse for delaying the circulation and filing of quarterly accounts, which is a separate mandatory requirement under Section 245 and also the plea of illness of accountant and engagement of the management in arranging the AGM matters was also not convincing. Accordingly, the default was considered deliberate and intentional, attracting penal provisions. However, keeping in view the satisfactory track record of the Company with regard to filing of interim accounts in the past, a lenient view of the matter was taken and a fine of Rs.25, 000 was imposed.

Taxation of Royalty Income

By SALMAN HAQ

Advancements in E-commerce and satellite communication has expanded the business horizons beyond geographical boundaries and the question of territorial nexus in matters of taxation is becoming increasingly complicated. Businesses can now be conducted without actually having any business connection in a country. It therefore, became a matter of concern for tax quarters to drag remittance to non-resident for use of advanced technological facility or equipment into the tax net since there were no express provisions of law in this discipline. The meaning of the expressions Royalty, fee for Technical services and business or commercial profits became the moot point in general discussions at various tax forms especially in the context of such remittances being made to non-residents. Thus, subscription fee for viewership of visual images and sounds transmitted via satellite was interpreted by the tax authorities to be in the nature of "royalty" or "fee for technical services" as it suited them from tax collection perspectives. On a similar notion the Internet Service Providers (ISPs) and Data Network System Operators using satellite facilities of the non-resident were also deemed to be making payment of "royalty" or "technical service fee" to these non-residents for using such facilities. Whereas the tax payers, heavily armoured by their tax advisers maintained that such payments were ineffect a "service fee" for utilizing the services offered by the non-resident, their plea, however, was ignored, perhaps in the larger interest of Revenue.

2. In this labyrinth of conflicting opinions the issue of interpretation of these terms, however, was laid to rest by a land mark decision of the Hon'ble Income Tax Appellate Tribunal in a celebrated case reported as 2002 PTD 2679 (Trib.) In this case a non-resident corporation of USA has set-up a satellite in the space over Indian Ocean in earth's orbit which had various transponders to facilitate the transmission of signals. The non-resident corporation allocated some of the frequencies to its customers in Pakistan which were used to transmit or receive internet signals. The non-resident company charged monthly service fee from its customers in Pakistan for the use of this facility. The assessing officer while finalizing the assessment of the non-resident company treated the receipts, remitted to it, as "fee for technical services" thus making it taxable under section 80AA and 12(5) of the Income Tax Ordinance, 1979 (the Repealed Ordinance). The dispute remained that whether the receipt of the Corporation was in the nature of commercial profits or fee from technical services. The learned Tribunal held that the obvious reason for which the non-resident corporation has set-up the satellite in the space was to earn income. Therefore, fees received by it can under no circumstances be termed as "Fee for Technical services" and are thus clearly in the nature of "Commercial Profits".

3. The aforesaid decision of the learned Income Tax Appellate Tribunal allowed a sigh of relief to non-residents providing advanced technological, facilities to their customers in Pakistan. It must be appreciated that commercial profits arising to a non-resident not having a permanent establishment in Pakistan, is exempt from chargeability of tax in Pakistan under the various Double Taxation Treaties that Pakistan has. On the other hand, receipts on account of royalty or fee for technical services would squarely be taxable in Pakistan though at a lower rate, as provided for in the Treaties.

4. However, the euphoria of such non-residents remained only short lived. The Income Tax Ordinance, 2001 which has come into effect from July 1, 2002 has substantially modified the meaning of the word "Royalty" so as to include within its meaning any consideration received on account of receipt of, or right to receive any signal transmitted via satellite, cable optic fiber or any other similar technology. The definition has also covered payments made for use of or right to use any scientific, industrial or commercial equipment thereby catering for any argument of the tax payers to prove otherwise than the above covert intention of the legislature. This broad base spectrum of the expression "royalty" as used in the Ordinance has already awed the tax payers but the after math of its implications are yet to be witnessed. Before we proceed any further to discuss the consequences of such a wide range definition it would be appropriate to reproduce the definition as contained in Clause (54) of Section 2 of the Ordinance.

"(54) "royalty" means any amount paid or payable, however described or computed, whether periodical or a lump sum, as consideration for -

(a) the use of, or right to use any patent, invention, design or model, secret formula or process, trademark or other like property or right

(b) the use of, or right to use any copyright of a literary, artistic or scientific work, including films or video tapes for use in connection with television or tapes in connection with radio broadcasting, but shall not include consideration for the sale, distribution or exhibition of cinematography films;

(c) the receipt of, or right to receive, any visual images or sounds, or both, transmitted by satellite, cable, optic fiber or similar technology in connection with television, radio or internet broadcasting;

(d) the supply of any technical, industrial, commercial or scientific knowledge, experience or skill;

(e) the use of or right to use any industrial, commercial or scientific equipment;

(f) the supply of any assistance that is ancillary and subsidiary to, and is furnished as a means of enabling the application or enjoyment of, any such property or right as mentioned in sub-clauses (a) through (e);

(g) the disposal of any property or right referred to in sub-clauses (a) through (e);"

5. A comparative review of the above definition of royalty with the definition as contained in the Repealed Ordinance suggests that entrants in sub-clause (c), (e) and (g) are new to the term. As mentioned earlier, these insertions are made to cater for the taxation of Pakistan source income derived by the non-resident. It needs to be appreciated that under general parlance of language, consideration received by an entity from rendering services, may though be through sophisticated scientific or technical equipments would be termed as it's business income where it is the business of the entity to render those services. However, by virtue of the above definition these receipts would now be classified as royalty income. Accordingly, local TV Channels, interest service providers, data network system operators, cable system operators, private TV channel operators, telecommunication service providers, mobile phone companies etc. making payments to non-residents on account of receipt of, or right to receive any signal transmitted via any mode of communication, would also be termed as royalty and would be subject to tax in Pakistan as such, unless the Treaty provides for otherwise.

6. There is another important aspect of the definition of "royalty" which arises from sub-clause (g) of the definition. It has expressly been provided that consideration received on disposal of any royalty right will also be clarified as royalty income. This is a major shift from the provisions of taxation of Royalty as previously were contained in the Repealed Ordinance which specifically deemed consideration on disposal to be taxable under the head "Capital Gain". Consequent to this new definition sale of intellectual property rights, including copyright, patent, invention, secret formula, computer software programmes would now constitute royalty in the hands of the recipient and hence would be taxed, accordingly. This change in the definition is bound to create hoax in practical implementation.

7. The provisions relating to chargeability of tax on royalty have also been modified to a certain extent. Under the Ordinance non-resident are taxable only on their Pakistan source income Sub-section (8) of section 101 of the Ordinance expressly provides that royalty shall be deemed to be a Pakistan source income if it is paid by a resident person or borne by a Permanent Establishment (PE) of a non-resident person in connection with the right, property or information used or service utilized for the purpose of a business carried on by it in Pakistan. The expression PE has also been appropriately defined in the Ordinance which is almost the same as assigned to it in the various treaties. Hence, any payment of royalty by a resident or a PE of a non-resident would, subject to the treaty, be chargeable to tax @ 15%. It must be noted that it is the gross amount which constitute the income of such non-resident and no deduction is allowed even when expenses have been incurred to derive royalty income. Tax so charged constitutes full and final settlement of tax liability of the non-resident in respect of Pakistan source royalty and is not chargeable to tax under any head of income as per section 8 of the Ordinance.

and is not chargeable to tax under any head of income as per section 8 of the Ordinance. Further, as in the Repealed Ordinance, the payer of such amount is again obliged to withhold tax at the time of making such payment at the prescribed rate under section 152 of the Ordinance.

8. However, the general principle of taxation of royalty as spelled out above does not apply in the following three circumstances as contained in section 6 of the Ordinance, read with Rule 18 of the Income Tax Rules, 2002 –

(a) where royalty is paid to a non-resident by a resident person or the PE of the non-resident person in pursuance of an agreement made before the 8th day of March, 1980 or an agreement made on or after the said date the proposal in respect of which was approved by the Government before the said date in which case such royalty will be treated as "income from other source" and expenditures paid by the persons in deriving such income as admissible under section 40 of the Ordinance, shall be allowed against such income.

(b) Where

(i) payment is made to a non-resident under an agreement other than those specified in (a) above: and

(ii) the property or right giving rise to such royalty is effectively connected with a PE in Pakistan of the non-resident person,

then payment of such royalty will be treated as "income from business" attributable to the permanent establishment in Pakistan of the non-resident person against which the following expenses will be allowed –

(i) any expenditure incurred in Pakistan to earn such royalty, wherever paid.

(ii) any expenditure incurred outside Pakistan in pursuance of such agreement not exceeding ten percent of gross amount of royalty.

However, the non-resident has been provided with an option to have such income charged to tax at specified rate on the gross amount of such royalty in which case it will constitute full and final discharge of the tax liability of the tax payer. However, to avail such option, the non-resident is required to file a written application within 15 days of the commencement of contract which shall remain operative till completion of the said contract. In case where the tax payer exercises such an option, no deductions as mentioned above will be available to him.

(c) Where payment of royalty is made in pursuance of any other agreement where the tax charged/collected does not constitute full and final settlement of tax liability of the non-resident in which case the following expenses will be allowed.

(i) any expenditure incurred in Pakistan in earning such royalty;

(ii) any expenditure incurred in Pakistan in respect of any work done in pursuance of such agreement.

(iii) any expenditure incurred outside Pakistan in respect of any work done in pursuance of such agreement not exceeding ten percent of the gross amount of such royalty.

9. It is essential to mention here that mere existence of a PE of the non-resident in Pakistan does not qualify the receipts of the non-resident to be termed as "income from business" of the PE of the non-resident as provided for in situation (b) above. It is most crucial that the right or property giving rise to the royalty must be "effectively connected" with the PE of the non-resident in order to classify it as the business income of the PE. The expression "effectively connected" has again not been defined in the Ordinance and may lead to interpretation against the interest of the tax payer.

10. As regard royalty received by a resident person, unless subject to tax as income from business, it is to be taxed as income from other sources against which expenses paid in deriving such income as allowable under section 40 of the Ordinance are available. Such royalty is subject to normal rate of taxation as applicable to that person. Further, no withholding tax provisions are attracted to such payments. However, royalty received by companies registered under the Companies Ordinance, 1984 and having their registered office in Pakistan from a foreign enterprise as consideration for the use outside Pakistan of any patent, invention, model, design, scientific, process or formula or similar property right or information concerning industrial, commercial or scientific knowledge, experience or skill made available or provided to such enterprise by the company continues to remain exempt from charge of tax under Clause (13) of Part-I of the Second Schedule to the Ordinance provided that such income is received in Pakistan by or on behalf of the said company (Clause (139) of Part I of the Second Schedule to the (Repealed Ordinance) However, where any such royalty received is not brought into Pakistan in the year in which it is earned, and tax is paid thereon, then the amount equal to the tax so paid will be allowed to be deducted from the tax payable by the company for the year in which it is brought into Pakistan. Where however no tax is payable by the company for that year or the tax payable is less then the amount to be deducted, the excess is allowed to be carried forward and deducted from the tax payable for the year and so on till fully adjusted.

11. In conclusion I would say about tax what W.I. Gates once said about law. "*If there is no tax, there will be*". Income Tax Ordinance, 2001 has done just that by widening the scope of the expression "royalty"