# *Tax Review/Taxation*

## Daily Alert Services

**Huzaima & Ikram**
*October 10, 2013*

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This issue contains:



Kind regards

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# Onslaught of SROs continues!

by
*Huzaima Bukhari & Dr. Ikramul Haq*

International Monetary Fund (IMF) and other lenders must by this time have learnt that ruling elites of Pakistan are simply incorrigible! They have demonstrated time and again extreme apathy towards problems faced by the weaker segments of society—there is consensus now that Pakistan is meant only for privileged classes. This apathy becomes criminal when the economic plight of millions is worsening with every passing day, but the privileged classes, instead of paying their taxes are bent upon enjoying life at the expense of the poor and getting more and more tax benefits.

On 4 October 2012, according to a newspaper, "Pakistan has backtracked on its commitment to the International Monetary Fund (IMF) that it will not issue any new statutory regulatory order (SRO) for tax exemption and instead issued four SROs to give benefits to industrialists and exempt retailers from registration." The report was referring to a number of SROs issued by the Federal Board of Revenue (FBR) on the direction of Ishaq Dar to offer tax breaks to the affluent "who had threatened to stage a country-wide strike." This decision was not only contrary to the agreement signed with IMF but unconstitutional in view of Article 77 read with Article 162 of the Constitution of Pakistan. Through these SROs, the government bypassed the Parliament and committed open violation of the latest dictum of Supreme Court in the case of *Engineer Iqbal Zafar Jhagra and Senator Rukhsana Zuberi v Federation of Pakistan and Others* 108 TAX 1 S.C. Pak that says:

> "It is well settled proposition that levy of tax for the purpose of Federation is not permissible except by or under the authority of Act of Majlis-e-Shoora (Parliament). Reference in this behalf may be made to the case of *Cyanamid Pakistan Ltd. V. Collector of Customs (PLD 2005 SC 495),* wherein it has also been held that such legislative powers cannot be delegated to the Executive Authorities. Also see *Government of Pakistan v. Muhammad Ashraf (PLD 1993SC 176) and All Pakistan Textile Mills Associations v. Province of Sindh (2004 YLR 192)."* ***[Page No. , Para 20]***

The major "concession" given through SRO was reduction in sales tax on purchases from unregistered persons from 17% to 1%! Rate of sales tax was reduced from 5% to 3% on imports and supplies of fabrics and tax on value addition was further cut to 2%.

In Memorandum of Economic and Financial Policies (MEFP) submitted by the PML-N government to the IMF for securing $6.7 billion Extended Fund Facility (EFF) it was stated that "the government has already stopped issuing any new tax concessions or exemptions (including customs tariffs) through SROs except for an Act of Parliament." Issuance of SROs on 4 October 2013 is negation of their own stance as well as a clear understanding given to IMF that "the government would approve laws by the end of December 2015 to permanently stop issuing SROs." Time and again the government of PML-N has said that its "three-year tax base expansion plan hinges on eliminating exemptions and concessions embedded in SROs and in the law, as well as on eliminating powers of the executive to grant preferential tax treatment through SROs." However, as actions speak louder than words, it just proves how hypocrite these rulers are and how others are justified in calling us cheats and liars.

According to a Press report, "Analysts describe the new SROs as a major blow to the drive aimed at broadening the tax base, which also put a question mark over the ability of the government to sustain pressure." It is pertinent to mention that last year only 711,000 people filed income tax returns while the number of active registered sales tax payers was below 100,000," exposing the extreme inefficiency of FBR.

The report went on to say that "like its predecessors, the PML-N government too increased the burden on existing taxpayers in the new budget and the only measures that it took to encourage people to come into the tax net were eventually withdrawn. The preferential tax treatment is expected to cause a revenue loss of at least Rs.10 billion against government's claim of less than Rs. 5 billion. This loss may make it more difficult to meet the annual tax target of Rs. 2.475 trillion. The revenue board has already missed its first quarter target by a wide margin."

According to an SRO, the government also withdrew a condition that had required retailers to submit their address, computerised national identity card number and national tax number with their withholding statement. This will keep retailers out of the tax net, leaving a significant sector out of the formal economy. The same SRO reduced the amount required to be withheld by wholesalers, dealers and distributors from 20% of total sales tax to 10% of tax. Through SROs 895 and 896 of 2013, the government removed dozens of items from the Third Schedule of Sales Tax Act 1990. Before the omission, the manufacturers were bound to print price and sales tax amount on their products and withhold sales tax. These items were added in the Third Schedule at the time of announcement of budget with estimates that Rs. 8 billion would be collected on this account.

The items removed from the Third Schedule include household electrical goods such as air conditioners, refrigerators, deep freezers, television sets, recorders, electric bulbs, tube-lights, fans, irons, washing machines as well as telephone sets and household gas appliances. Other items deleted from the schedule were ovens, mattresses, auto parts, lubricant oils, tyres and tubes, storage batteries, arms and ammunition, paints, distempers, enamels, pigments, varnishes, gums, resins, dyes, glaze, tiles, biscuits and chocolates.

From above, it is obvious that that only have our economic managers miserably failed to bring the country out of the prevailing economic crisis, they have even given up all efforts to do so. They are openly violating commitments made with international lenders at the time of making agreements, especially with the IMF as earlier government did in 2008. The grim economic challenges—monstrous external and domestic debts, rising fiscal deficit, crushing inflation, record unemployment, just to mention a few—are still persisting and assuming dangerous levels but the government is least pushed to take concrete and urgent measures suggested by experts time and again. On the contrary, the government is resorting to many unwise policies that may push the country towards total economic collapse.

We have an established history of backtracking. The IMF expressed positivity in 2010 even after the government failed two agreed deadlines of introducing Value Added Tax (VAT): first was 1 July 2010 which was later extended to October 2010. The government failed to impose VAT even in budget 2011 which obviously annoyed IMF and it suspended any further tranche. Pakistan also failed to meet many other obligations agreed with IMF. After FBR's figure fudging drama—brilliantly exposed by the media—our authorities were unable to face the IMF. This was perhaps the main reason behind the reported decision "not to pursue the IMF programme any further." It was simply tragic—a heavy price that nation had to pay for FBR's follies, and the irony is that those people are still controlling FBR!

We need economic reforms on all fronts to come out of the existing crisis. It hardly matters whether IMF is here or not. We need economic discipline for our own survival. In 2008, the IMF for its "generous" lending demanded imposition of VAT with effect from 1 July 2010—the government after getting the VAT Bill approved from Senate abandoned the idea for reasons best known to it. Even in the Finance Bill 2011, there was no mention of introducing VAT though our Finance Minister promised IMF that VAT would be imposed from October 2010. He sought time from IMF for enforcing VAT and what happened afterwards is history. This is the way we make commitments and violate them at the highest level without any remorse.

Now Ishaq Dar has breached the agreement with IMF by issuing concessionary SROs giving the message, "We are incorrigible and obstinate." This is simply insane! Our rulers are plundering money from all sources—collected through taxes or obtained as loans. Almost every expert has pleaded that for wasting borrowed money, the fault lies with Pakistan's ruling classes and not with the IMF or World Bank. Had economic reforms been implemented and structural changes made, Pakistan could have improved its financial governance, but funds were ruthlessly squandered by the elite. On the one hand, this nation has become heavily indebted and on the other, all systems have been further destroyed with unabated corruption, inefficiency and incompetency.

Both the government and experts, pleading for more taxes, should realise the fact that real problem lies elsewhere: non-taxation of the rich and wasteful spending by the rulers. Under the existing inequitable system, the burden of taxes is less on the rich and more on the poor. Taxes, in the nature of full and final discharge of liability, are withheld even from those who have incomes below the taxable threshold. These taxes cannot be termed as income tax. These are transaction taxes or taxes on consumption. Being regressive in nature, such levies take a larger portion of income of the poor and a negligible part of hefty incomes of the rich. These taxes make the rich richer, and the poor poorer.

Over a period of time, our tax system has become rotten, oppressive, unjust and target-oriented. There is a dire need for discussing the philosophical framework, principles of equity and justice, which should be the main concern of our tax policy; not mere achieving of revenue targets. Our tax managers are meeting budgetary targets through oppressive taxes, shifting incidence on the poorer segments of society and exempting the rich. They are not tapping the real tax potential that is not less than Rs. 8 trillion. The great divide between the poor and the rich is expanding. FBR has proved to be an inefficient and corrupt organisation. 80% collection is through withholding taxes. It could be outsourced to any reputed firm that would bring more taxes through better management and IT tools.

On the one hand, we are not collecting taxes according to the constitutional principle of 'capacity to pay' and on the other, annual targets are fixed to further squeeze the already dried tax base—there is no political will to tax the rich and mighty absentee landlords, big property owners and those who are engaged in wasteful expenditure. Rich absentee landlords conveniently remain outside the tax net, while the poor are paying 16% GST on even a basic commodity like salt, sold under brand names. When tax was imposed on salt in the colonial era, the visionary leaders of that time staged a revolt against such high-handedness. But in the post-independence period, our rulers are playing havoc with the economic life of the poorest by levying exorbitant tax on salt and many other everyday eatable commodities, besides enhancing the prices of utilities and POL prices beyond the capacity of the income of vast majority of the population.

It is well-established that our inept rulers and inefficient taxmen are the real culprits responsible for our debt enslavement. For example, there was no justification to raise the GST rate to 17% in the Budget 2013-14—at that time IMF was not even in picture. Time and again we have highlighted the need for bringing GST rate to a single digit of 8% across the board with effective enforcement, and concentrating more on reduced spending on defence and developments, each by a third, cutting tax rates, eliminating all exemptions and concessions, and broadening the tax net. Once it is done, then FBR must put tax audits on a war footing, targeting all those who pay taxes but under-file massively (including government servants), and taxing them all on the true and fair market value of their undeclared, hidden assets, at home and abroad. Then, re-visit the documentation exercise with a view to catch those <u>outside</u> the tax net all together (this would also help quantify the extent of under-filing).

The real tax potential of tax collection of Pakistan—a cursory look at undeclared income/wealth would prove it—is not less than Rs. 8 trillion [**'FBR's *Year Book 2012-13*'**, *Business Recorder,* September 27, 2013]. If we manage to collect annual tax revenue of even Rs. 4 to 5 trillion in the coming three years, the government's reliance on domestic and foreign loans can decrease significantly. This is, however, not possible unless FBR is converted into an autonomous body run by competent, honest and efficient persons. Collection of taxes worth these levels can eliminate budget deficits. Resultantly, Pakistan can concentrate positively on retiring costly debts in the shortest possible time and making huge savings on debt servicing—it is paying Rs. 1154 billion on this account alone in the current fiscal year and it will exceed substantially next year. In fiscal year 2012-13, FBR collected just Rs. 1932 billion while Pakistan's outflow on debt servicing alone was Rs. 980 billion. The only way out is to collect taxes at least to the tune of Rs. 5 trillion which, is not possible unless tax enforcement is ensured at all levels, collection leakages are plugged and FBR is restructured.

## Jersey

### Jersey Proposes Tax Cuts In 2014 Budget

Jersey's 2014 Budget, published on October 08, 2013, proposes reducing the marginal rate of relief for individual income tax from 27 percent to 26 percent.

The marginal rate of relief works to reduce the tax payable by low and middle earners and applies to income over an earnings threshold. A reduction in Jersey's marginal rate would reduce the tax liability of around 84 percent of taxpayers (about 40,000 households) by GBP7.8m.

The Budget also proposes an increase in the income tax exemption thresholds. This would cut tax by GBP2.5m for approximately 84 percent of taxpayers.

Also included in the 2014 Budget is a GBP3,000 increase in the tax allowance for parents in the marginal tax band who are paying to put children through higher education. The enhanced allowance would be GBP9,000 per child. This measure would benefit more than 1,000 families and leaves lower and middle income families GBP900,000 better off.

In announcing the Budget, Jersey's Minister for Treasury and Resources, Philip Ozouf, said: "This is a budget that cuts taxes, invests in essential infrastructure for the long-term benefit of the Island and gives something back to the hardworking people of Jersey, who have carried on through difficult economic times. It is a budget that supports the Island's needs for economic growth, job creation, better education and better healthcare." – *Courtesy tax-news.com*

## Bermuda

### Bermuda Levies Tax On Oil Imports

Bermuda is on its way to introducing a tax on oil imported via the docks of the historic town of St George's.

The tax will be used to raise funds to protect the town's UNESCO World Heritage site status. It was approved by Bermuda's MPs on October 03.

The details of the tax, including the date of its implementation and whether it can be passed on to consumers, have not yet been confirmed.

David Rose, CEO of RUBiS Energy Bermuda, said of the tax: "We can't absorb any more costs in this financial climate. We as oil companies simply cannot pass on a tax. It's the Ministry of Finance which allows for any new tax being recouped." – *Courtesy tax-news.com*

## Germany

### Germany's Opposition Abandon Tax Rise Ultimatum

Perhaps sensing the futility in their demands, Germany's main Opposition parties, the Social Democrats (SPD) and the Green Party, have moved away from their ultimatum that tax rises must be included in any future coalition agreement with German Chancellor Angela Merkel and her newly elected Christian Democratic Union (CDU) party.

Indeed, while insisting that tax rises must not be an end in themselves, SPD Chairman Sigmar Gabriel nevertheless warned that the CDU must put forward alternative proposals to secure financing for future investment in education, infrastructure, and towns and communes in Germany, without recourse to greater debt.

Echoing this stance, the Green Party's Kerstin Andreae made clear that tax rises are not compulsory, emphasizing that the party would welcome other measures aimed at financing the energy transition and vital infrastructure projects. The Green Party will not agree to any measures that might increase state debt as a result, however, Andreae said.

These latest concessions will come as a huge relief to Chancellor Merkel as the coalition negotiations continue, especially given the tough stance adopted by her own party. Firmly ruling out the idea of tax rises, the CDU's General Secretary Hermann Gröhe underscored that increasing the fiscal burden is simply the wrong path. German Finance Minister Wolfgang Schäuble (CDU) has steadfastly maintained his opposition to the idea of tax rises, pointing out that the state must make do with the money it has. Bavaria's Prime Minister and leader of the CDU's sister party, the Christian Social Union (CSU), Horst Seehofer recently reiterated his pledge that there will not be tax rises with his party.

There are, however, alternatives to wealth-related taxes that could be explored. The SPD champions the idea of a Europe-wide

Financial Transactions Tax (FTT) as a means with which to generate much-needed additional fiscal revenue for the state. Although the idea of a FTT only currently appears feasible within the framework of enhanced cooperation, Chancellor Merkel could be persuaded to spearhead a greater push for the levy at European level.

Another idea currently being mooted is the possibility of abolishing certain expensive and controversial tax breaks, most notably the value-added tax break (VAT) currently benefiting the hotel industry, and the tax shelter for agricultural diesel and aviation fuel. – *Courtesy tax-news.com*

**European Union**

**EU Offers Update On Trade Negotiations**

The European Union's (EU) preparations for the application of a Deep and Comprehensive Free Trade Area (DCFTA) with Ukraine, Georgia, and Moldova are going well, officials have said.

The EU's Trade Policy Committee met recently to consider the main points of the Union's Trade Policy Agenda, and to prepare for a trade-focused meeting of the Foreign Affairs Council on October 18. Informal meetings of the Committee are organized semi-annually, and take place in the country presiding over the EU Council – in this case, Lithuania.

The meeting focused on the EU's trade relationship with the Eastern Partnership countries. Committee members agreed that preparations for the temporary application of the DCFTA to Ukraine are progressing smoothly, but admitted that the end result will depend on the carrying out of the attached political conditions. The documents relating to Georgia and Moldova are being prepared for signing.

Members expressed concern that Russia is applying political and economic pressure on the Partnership countries and on Lithuania. The Committee welcomed the European Commission's reaction to a Russian import ban on Moldovan wine, and discussed other possible actions to help the Partnership cope with Russian activity. Members also stressed that negotiating with Russia uniformly will be crucial in future. – *Courtesy tax-news.com*

## Switzerland

### Swiss People's Party Slams Vignette Tax Hike Plans

The Swiss People's Party (SVP) has fiercely criticized the Swiss parliament's decision to increase the cost of the motorway vignette by 150 percent, underlining the need to vote against the "massive additional burden" in the upcoming referendum on November 24.

Defending its position, the SVP highlighted the fact that the Federal Government already collects around CHF9.5bn (USD10.5bn) annually in road traffic taxes, duties, and fees. Of this considerable sum, barely one-third flows to finance road infrastructure in the Confederation, while the remaining two-thirds passes to the Federal Treasury, to public transport, and to the cantons, the SVP stressed.

Furthermore, the SVP argued that plans to dramatically increase the motorway vignette will not yield greater value, highlighting the fact that the resulting additional funds have already been earmarked for existing road maintenance. Given that these costs are currently borne by the Swiss cantons, the proposal merely shifts the burden from one level (cantonal) to another (federal), the party emphasized.

As a further argument, the SVP maintained that without years of road fund misappropriation, there would simply be no need to increase the vignette, or to increase fuel duties, as recently announced. The SVP also warned that the 150 percent price hike will impact most heavily on small- and medium-sized companies in Switzerland with a large fleet, suggesting that this cost would in turn be passed on to consumers.

Finally, the SVP lamented that fact that the measure will merely serve to further disadvantage Swiss nationals, noting that a new law now enables foreigners using Switzerland's road network to purchase a two-month vignette at a cost of just CHF40.

While underscoring the central importance of a well-maintained and well-developed road network for Switzerland as an economic location, the SVP concluded by reiterating that current income derived from taxes on road traffic is already more than sufficient to meet the Confederation's infrastructure requirements. – *Courtesy tax-news.com*

**Uniform ST rate on fabrics criticised**

The value-added textile sector is critical of the Federal Board of Revenue (FBR) for imposing three per cent uniform rate of sales tax on all fabrics.

No distinction has been made between finished and raw fabric.

In a joint statement on Wednesday, the leaders of value- added textile sector said for domestic consumption they may endure three per cent sales tax.

However, sales tax should be two per cent on finished fabric meant for export of garments.

They stated that two per cent sales tax is already being charged on the entire chain, starting from yarn purchase to dyeing to other stages by exporters.

These leaders expressed their dismay over the situation and said when the Federal Board of Revenue (FBR) earlier tried to impose three per cent tax on all categories of fabrics, it failed because at that time PML (N) was sitting in the opposition and opposed the move.

They found it surprising that now in government, the PML (N) had initiated a move it knows will hurt the business.

They further added that huge outstanding amounts towards sales tax refund, customs rebate, FED and DLTL claims are causing severe liquidity crunch and exporters are unable to meet their future export contracts.

The higher sales tax would mean greater liquidity crunch.

They stated that sale of finished fabric to manufacturer-cum-exporter be charged at 2pc and the status of value-added textile export sector's zero-rated status be maintained so that hassle of refund is eliminated which also promotes corruption.

The leaders who jointly issued the statement include Dr Miza Ikhtiar Baig, chairman, Pakistan Denim Manufacturers & Exporters Association, Irfan Z Bawany, chairman, Pakistan Hosiery Manufacturers and Exporters Association, Khwaja Mohammad Usman, chairman, Pakistan Cotton Fashion Apparel Manufacturers and Exporters Association, M Jawed Bilwani, chairman, Pakistan Apparel Forum, Kamran Chandna, chairman, Pakistan Knitwear and Sweater Exporters Association and Arshad Aziz, chairman, Readymade Garments Manufacturers and Exporters Association. – *Courtesy Dawn*

## Violation of ST refund procedure: FBR to initiate action against taxmen

The Federal Board of Revenue has decided to initiate disciplinary proceedings against the tax officers, who deliberately broken the queue to pay sales tax refunds to the registered persons on their discretion. Sources told here on Wednesday that the FBR has issued instructions to the Chief Commissioners of all Large Taxpayer Units (LTUs) and Regional Tax Offices (RTOs) regarding reported violation of sales tax refund procedure.

The method of 'first come first serve basis' has to be strictly followed for payment of sales tax refunds. The FBR has warned the field formations that reportedly some junior officers have broken the queue for payment of sales tax refunds. The FBR had strictly directed the LTUs/RTOs that the sales tax refund cheques to be issued following Refund Payment Order (RPO) on first come first serve basis as per date of RPOs. Instead of adopting the procedure of 'first come first serve basis', some field officers have used their discretion for payment of refunds by breaking the queue.

The FBR has warned the Chief Commissioners of all LTUs and RTOs that the Board would take disciplinary action against junior officers who have violated the Board's instructions by adopting different techniques. Earlier, the Board said that the Sales Tax Refund Rules, 2006, notified under SRO 555(1)/2006 dated 5th June, 2006 prescribed procedure for processing and sanctioning of sales tax refund. Presently, sales tax refund claims are processed through ERS where these are filed by the manufacturers cum exporters (Zero Rated Sectors) against export sales whereas claims of other claimants are processed in respective LTUs/RTOs. Instances have come to the notice that propriety of refund processing has left much to be desired. In order to fortify equity and transparency in the whole process, following instructions have been issued for proper implementation of the Refund Rules 2006:

In the Expeditious Refund System (ERS), the claims shall be processed through supply chain and the cheques shall be issued against Refund Payment Order (RPO) on first come first serve basis as per dates of RPOs. Unverified amounts shall be referred to respective LTU/RTOs for disposal as per law/rules, FBR said. The FBR has further directed the field formations that the refund claims that are filed in RTOs/LTUs shall be replicated immediately when the same are received. Objection memo shall be issued where any information is required from the claimant.

The claims shall be processed on first come first served basis. For this purpose, the queue shall be maintained on the basis of the receipt of the refund claims. However, the claim lacking any document/information shall be blocked by the system and next claim in the line shall be processed with the approval of the refund sanctioning authority. Similarly claim warranting immediate processing on account of Court/FTO orders shall be given priority with the approval of the refund sanctioning authority, FBR maintained.

The FBR further said that the blocked claim shall retain its position in the queue in the computer system and shall be processed after documents/information is furnished. The management information system (MIS) report in respect of claims processed by breaking the queue shall be available to the concerned officers of LTUs/RTOs for proper management and monitoring. – *Courtesy Business Recorder*

## Firm's appointment: FBR to seek Law Division's opinion

The Federal Board of Revenue will file a reference with the Law and Justice Division to seek opinion on the appointment of the law firm defending case filed by M/s Agility against Pakistan at International Centre for Settlement of Investment Disputes (ICSID), which involves compensation of US $63 million.

Sources told here on Wednesday that Board-in-Council of the FBR has taken the decision to file reference with the Law and Justice Division to know about the legality of hiring the law firm. Board-in-Council has principally agreed to get the services of the Law Firm of Ahmer Bilal Soofi to defend FBR before ICSID in the case of M/s Agility vs Government of Pakistan. The final decision would be taken after obtaining clearance form the Law and Justice Division.

Sources said that the claim filed by M/s Agility is of about $63 million including service charges, demurrages and interest etc. The FBR will try its level best to defend the case to avoid payment of such huge compensation of US $63 million. Board-in-Council also discussed threadbare the organisational restructuring of Directorate General of Intelligence & Investigation (Inland Revenue). It was agreed that the directorate of intelligence IR may not exercise powers of the broadening the tax-base (BTB) as the FBR is issuing notices to the potential persons for broadening the tax base through the centralised system. The Commissioner Broadening the Tax-Base FBR House Islamabad is issuing the notices for expanding the tax net and same functions are already being performed by the directorate. The agency also presented its revised functions and duties which would be examined by the FBR for further action.

The Board-in-Council also discussed the issue of ratification of income tax circular issued by different FBR Wings. It was pointed out that the FBR can issue circular under section 3 of the FBR Rules 2007. The circular are issued after obtaining approval of the concerned tax authorities empowered under the law. Under the FBR Rules 2007, the Board may delegate its powers and functions to the Chairman or the line member, functional member and support member who shall transact such business, and exercise such powers and functions singly as Board, as may be allocated to him.

The Chairman may distribute the powers and functions, and the business of the board amongst its members as he may deem fit. Until the powers, functions and business of the Board are delegated or distributed under this rule, any power exercised, function performed and business transacted by the chairman or a member shall be deemed to have been allocated to him there under.

Any power, function or business of the Board so exercised or transacted by the Chairman or any member shall be ratified by the Board provided that the powers so exercised, functions performed and business transacted fall under section 4 of the federal Board of Revenue Act, it added. – *Courtesy Business Recorder*

## Bilateral ST adjustment: FBR to share draft MoU with SRB, PRA and KPRA

The Federal Board of Revenue would share draft Memorandum of Understanding (MoU) with the Sindh Revenue Board (SRB), Punjab Revenue Authority (PRA) and Khyber Pakhtunkhawa Revenue Authority (KPRA) for seeking their comments on the proposed mechanism of bilateral sales tax adjustment between federation and provinces.

Sources told here on Wednesday that the initial draft of the MoU has been prepared by the expert team of the FBR. The draft would be approved by the Board. Subsequently, the draft would be shared with all provincial revenue authorities/board particularly SRB for comments. The MoU can only be implemented with mutual consent of all the parties. The comments of the SRB, PRA and KPRA are very important for the implementation of the said MoU. Under the draft agreement, the FBR and provinces would have to agree on the mutual mechanism of cross adjustment of input tax. After every three months, the net adjustment would be worked out on the basis of modalities being finalised under the draft MoU.

The federation and the provinces would be able to bilaterally adjust the amount of sales tax following signing of the MoU. It is expected that a formal MoU will be inked between the FBR and provinces during the current month. Under the proposed bilateral agreement, the FBR will be able to carryout bilateral adjustment of the sales tax between federation and each of the provinces. After every three months, ie, each quarter of fiscal year, the FBR will estimate that how much dues are pending with the federation or provinces on account of input tax adjustment. The FBR will reconcile the data with provinces after every three months for the said bilateral adjustment of input tax, sources added. – *Courtesy Business Recorder*

**F.No.1(5)Jurisdiction/2013/135295-R**

Islamabad, the 2nd October, 2013

**ORDER**

In exercise of the powers conferred by Sub-Section (1) of Section 209 of the Income Tax Ordinance, 2001, Sections 30 and 31 of the Sales Tax Act, 1990 and Section 29 of the Federal Excise Act, 2005, Federal Board of Revenue is pleased to transfer the jurisdiction over the case of Mr. Abdus Samad Khan, NTN 1108733-1, from Chief Commissioner IR, RTO-II, Lahore to Chief Commissioner Inland Revenue, RTO, Islamabad.

2. This order shall take immediate effect.

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**F.No.1(1)Jurisdiction/2013/135292-R**

Islamabad, the 4th October, 2013

**ORDER**

In exercise of the powers conferred by Sub-Section (1) of Section 209 of the Income Tax Ordinance, 2001, Sections 30 and 31 of the Sales Tax Act, 1990 and Section 29 of the Federal Excise Act, 2005, Federal Board of Revenue is pleased to transfer the jurisdiction over the case of M/s Jahanzeb Contractor, NTN 3765935-9, from Chief Commissioner IR, RTO, Rawalpindi to Chief Commissioner Inland Revenue, RTO, Peshawar.

2. This order shall take immediate effect.

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**2013 TRI 1680 (Trib. Ind.)**

**INCOME TAX APPELLATE TRIBUNAL**
**AHMEDABAD "D" BENCH, AHMEDABAD**

# Mukul Kr. Shrawat, Judicial Member and Anil Chaturvedi, Accountant Member

## FACTS/HELD

**Srction. 14A/Rule 8D: Interest expenditure has to be netted against interest income and only the difference, if any, can be considered for disallowance**

1. In AY 2008-09, the assessee invested Rs. 95 lakhs in shares on which it earned Rs. 300 as dividend. The AO applied Rule 8D and made a disallowance of Rs. 15 lakhs. The assessee claimed that no expenditure had been incurred to earn the dividend income on the basis that while the interest expense was Rs. 1.83 crore, the interest income was Rs. 1.86 crore and there was a net surplus interest income of Rs. 3.79 lakh. The CIT(A) held that the AO had not established a nexus between the expenditure incurred and the tax free income and that as the assessee had net positive interest income, there could be no disallowance of the interest expenditure u/s 14A read with Rule 8D. He sustained the disallowance at 0.5% of the average investment. On appeal by the department HELD dismissing the appeal:

    No nexus has been established by the AO between the expenditure incurred by the assessee and the tax free income earned by him. Further, as the interest income was more than interest expense and the assessee was having net positive interest income, the interest expenditure cannot be considered for disallowance u/s 14A and Rule 8D (Trade Apartment (ITAT Kol) & Morgan Stanley (ITAT Mum) (both included in the file) followed)

*Appeal dismissed.*

**I.T. A. No. 2228/AHD/2012 (Assessment Year:2008-09).**

**Heard on: 12th June, 2013.**

**Decided on: 5th July, 2013.**

**Present at hearing: T. Sankar Sr. D.R., for Appellant. S.N. Divetia A.R., for Respondent.**

## JUDGMENT

*Per Anil Chaturvedi:– (Accountant Member)*

1. This appeal is filed by the Revenue against the order of CIT(A)-VIII, Ahmedabad dated 12.07.2012 for A.Y. 2008-09.

2. The facts as culled out from the order of lower authorities are as under.

3. Assessee is a company engaged in the business of Finance. It electronically filed its return of income on 25.08.2008 declaring total income at Rs. NIL after set off of carry forward losses. The case was selected for scrutiny and thereafter assessment was framed under 143(3) vide order dated 25.10.2010 and the total income was assessed at Rs. 15,45,700/-. Aggrieved by the order of Assessing Officer, Assessee carried the matter before CIT(A). CIT(A) vide order dated 12.07.2012 granted partial relief to the Assessee. Aggrieved by the aforesaid order of CIT(A) the Revenue is now in appeal before us and has raised the following effective ground:–

> *1. The Ld. CIT(A) has erred in law and on facts in deleting disallowance of Rs. 15,63,883/- made u/s. 14A of the Act, without appreciating the fact that there was no nexus that could be established with the amounts incurred by the assessee for earning the tax free income.*

4. During the course of assessment proceedings, Assessing Officer noticed that Assessee has made investment in shares amounting to Rs. 95,45,400/-. Assessing Officer was of the view that the investment would generate exempt income and therefore provisions of section 14A becomes applicable. He accordingly applying the formula prescribed in Rule 8D of Income Tax Rules 1962 worked out disallowance under Section 14A of Rs. 15,63,883/-. Aggrieved by the order of Assessing Officer, Assessee carried the matter before CIT(A). CIT(A) after considering the submissions made by the Assessee granted partial relief by holding as under:–

> *4.3 I have gone through the assessment order and the submission of the appellant. During the course of Assessment proceeding, the Assessing officer noticed that the appellant had made investment in shares amounting to Rs.95,45,400/- so that disallowance of expenses was required to be made in view of section 14A of the Act in respect of interest expenses and administrative expenses the AO has worked out the disallowance of Rs. 15,63,883/- as per Rule 8D. The appellant has submitted that he has claimed only Rs. 300 as exempt income i.e. Dividend Income and it is submitted that no direct/indirect expenditure has been incurred to earn the exempt income. The appellant has submitted that the*

*dividend generally received through ECS and no specific expenditure incurred for collecting and depositing the said dividend in bank, therefore, no disallowance u/s 14A can be made for administrative expenses. The appellant has further submitted that he has incurred interest expenses of Rs.1,83,02,724/- as against interest income of Rs. 1,86,81,762/- and thus it has surplus interest income of Rs. 3,79,038/- and on that ground no part of interest can be disallowed u/ 14A read with rule 8D on the basis of the decisions of Kolkatta Bench of IT AT in case of Trade Apartment Ltd and the decision of Mumbai Tribunal in case of Morgan Stanley India Securities Private Limited. The appellant has further submitted that AO has not pointed out any particular expenditure that incurred for earning exempt income and while proposing disallowance u/s 14A, AO has failed to establish a pre-requisite nexus between the expenditure disallowed and the investments made from which income earned is exempt from tax. The appellant submits that there cannot be any presumption that the borrowings were made for the purpose of making any investment, consequently, the proposed addition by the Id. Assessing Officer is uncalled for.*

*4.4. On the identical facts in assessee's own case the Ld. ClT(A)Vlll in Appeal no. ClT(A)-VHl/lTO Wd-4(2)/657/09-10 dated 25.01.2011 for the A.Y. 2007-08 has held in para 4.3.2 on page no. 17 as under:–*

> *"In view of the details submissions of the appellant, it is categorically established that the interest expenditure has no direct nexus with the tax free investment. Secondly, the net interest expenditure is only Rs. 3,26,722/-.ln such a situation where appellant has net interest expenditure only of Rs. 3,26,722/- , the disallowance of gross interest is not justified. The case of Hero Cycles Ltd. (P & H) 323 ITR 22 supports this contention. In view of all the facts mentioned above the disallowance us/ 14A has calculated and submitted by the appellant above of Rs. 40769/- is confirmed. The remaining addition Rs. 494132/-is deleted."*
>
> *Therefore, in light of the above discussion, I am of the opinion that there was no nexus that could be established with the amounts incurred by the assessee for earning the tax free income. The appellant is also having net positive interest income which cannot be part for the disallowance in view of the basis of the decisions of Kolkatta Bench of IT AT in case of Trade Apartment Ltd and the decision of Mumbai Tribunal in case of Morgan Stanley India Securities Private Limited. At the same time, the appellant is incurring administrative expenses to maintain the above investments. In view of the*

*above, the amount of Rs. Rs. 47940/- which is 0.5% of average Investment of Rs. 94,45,400/- is taken as the disallowance u/s14A. In view of the facts of the case and the decision in the cases (supra) and following the decision of my predecessors, the disallowance made by the A.O. u/s 14A of the I.T. Act, 1961 cannot be fully sustained. In these circumstances, the A.O. is directed to delete the disallowance made by him of Rs. 15,08,803/-and Rs.7140/- on amount of interest under section 14A of the Act. The disallowance of Rs. 47940/- on administrative expenses is confirmed. The ground of appellant is partly allowed.*

5. Aggrieved by the order of CIT(A) the Revenue is now in appeal before us.

6. Before us, the learned D.R. relied on the order of Assessing Officer. On the other hand the learned A.R. submitted that provisions of Section 14A are applicable only when Assessee earns an income which is exempt from tax and incurs some expenditure for earning the aforesaid income. He further submitted that the Assessing Officer has to establish nexus between the expenditure incurred and the source of exempt income. In the present case, no nexus has been established by the Assessing Officer and therefore no disallowance under 14A can be made. The learned A.R. further submitted that the Assessee has received dividend of Rs. 300 which has been received through ECS and no specific expense has been incurred for collecting and depositing the dividend. He thus supported the order of CIT(A).

7. We have heard the rival submissions and perused the material on record. We find that CIT(A) while granting relief to the Assessee has given a finding that no nexus has been established by the A.O. with the amount incurred by the Assessee for earning the tax free income. He has further noted that in the Assessee's case the interest income was more than interest expense and thus the Assessee was having net positive interest income and therefore the same cannot be considered for disallowance and for which he placed reliance on the decision of Kolkata Tribunal in the case of Trading Apartment Limited and the decision of Tribunal in the case Morgan Stanley India Securities Private Limited. He however considered the administrative expenses to be 0.5% of the average investments and disallowed the same.

8. Before us the Revenue could not bring any material on record to controvert the findings of CIT(A). We therefore find no reason to interfere the order of CIT(A). Thus this ground of the Revenue is dismissed.

9. In the result the appeal of the Revenue is dismissed. Order pronounced in Open Court on 05 -07- 2013.