Tax Review/Taxation

Daily Alert Service

Huzaima & Ikram
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This issue contains:

Kind Regards,

Huzaima Bukhari
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A landmark judgement by SC

by

Huzaima Bukhari & Dr. Ikramul Haq

In a landmark judgement delivered on December 10, 2013, the Supreme Court of Pakistan held imposition of nine percent additional sales tax on supply of CNG (Compressed natural gas) as unlawful. The apex court, while directing the government to return the additional money received from the consumers, asked the Oil and Gas Regulatory Authority (OGRA) to issue a revised notification for standard rate of 16 or 17 percent of sales tax as early as possible but not beyond a period of seven days. In compliance of the order, OGRA on December 17, 2013 announced a cut in prices of CNG by Rs 1.23 per kilogramme. The same day, the government filed review petition against the order.

Highlighting crux of the matter, the Supreme Court held that “the Federation of Pakistan under Article 38 of the Constitution as a policy is bound to secure the well-being of the people by raising their standard of living.” It ruled that the subsidy already being given to the consumers should not have been withdrawn, adding “though the subsidy is not their right, the government being responsible for their welfare may consider in near future to increase the rate of subsidy by extending its benefits to the consumers”.

It may be recalled that additional sales tax of 9% on supply of CNG was levied by inserting subsection (8) in the Sales Tax Act, 1990 through the Finance Act, 2013, which reads as under:

> “Notwithstanding the rate of sales tax as contained in sub-section (1) and notwithstanding anything contained in any law or notification made there under, in case of supply of natural gas to CNG stations, the Gas Transmission and Distribution Company shall charge sales tax from the CNG stations at the rate of nine per cent in addition to the sales tax chargeable under sub-section (1) on the value of supply, where the value for the purpose of levy of sales tax shall include price of natural gas, charges, rents, commissions and all local, provincial and Federal duties and taxes, but excluding the amount of sales tax, as provided in clause (46) of section 2. This rate shall include the rate of tax chargeable under sub-section (1) and nine per cent in lieu of value addition made by the CNG stations. The rate of sales tax under this sub-section shall have effect and shall be deemed to have taken effect on and from the 1st day of July, 2007.
>
> ***Explanation:*** The rate of nine per cent in lieu of value addition is less than the standard rate of tax chargeable under sub-section (1), as all input tax adjustments have been catered for while determining the figure of nine per cent”.

The Supreme Court held that subsection (8) of section 3 of the Sales Tax Act, 1990, inserted by the Finance Act, 2013, was contrary to law and the Constitution. Declaring extra sales tax of 9 percent as untenable in law, it was categorically concluded by the apex court that imposition beyond rate fixed under section 3(1) of the Sales Tax Act, 1990 was not justified. The Supreme Court held that directions and the ratio of the judgment of June 21, 2013 in the case of *Iqbal Zafar Jhagra v Federation of Pakistan* [(2013)108 TAX 1 S.C. Pak = 2013 SCMR 1337], wherein Rule 7 of the Provisional Collection of Taxes Act, 1931 was declared ultra vires, shall be applicable in this case as well. The Supreme Court also observed that gas development charges (GDIC) "falls within the definition of Section 2(46) of the Sales Tax Act, 1990 and no order is required to be passed in this behalf".

The three-member bench of Supreme Court, headed by former Chief Justice Iftikhar Muhammad Chaudhry, has opined that "load-shedding of electricity in the country is manageable subject to dedicated and committed efforts to ensure the maximum possible generation of electricity which is sufficient to cater to the requirements of all consumers". The judgement says that "the competent authority must concentrate its efforts to minimise the sufferings of the consumers by endeavouring to provide uninterrupted supply of electricity… if, however, load-shedding is the only way out, it must be administered without having distinction between rural and urban areas as well as the domestic, commercial and industrial sectors. Moreover, a formula must be put in place to ensure the distribution of electricity on an equitable basis." The apex court further instructs that the competent authority shall take steps to control all kinds of losses by using modern devices like smart meters. It stresses that electricity should be supplied only to the consumers, who are ready to make payment, if need be, in advance or without any default after submission of the bills.

The judgement says that "as far as all kinds of unauthorised consumers are concerned, efforts should be made to persuade them to make payments of the bills, failing which action as envisaged under the Electricity Act, 1910, the Electricity Rules, 1937 and National Electric Power Regulatory Authority Act, 1997 as well as other enabling laws/rules, should be taken". The apex court has directed that "a policy has to be announced by the National Transmission & Despatch Company (NTDC)/Power Distribution Companies (Discos) under which the supply of electricity to the consumer who believes in law and make the payment in time is encouraged and supply to unauthorised consumers is discouraged." The judgement observes: The Court has held that it is responsibility of the National Electric Power Regulatory Authority (NEPRA) and Pakistan Electric Power Company (PEPCO) to reduce the prices while ensuring that "electricity is generated through less-costing value of production from hydel power…and as far as thermal power is concerned, preference must be given to generate electricity by using coal and gas, and unless there is no compulsion, the electricity should not be generated from RFO as it is casting higher prices, which ultimately has to be borne by the consumers".

The apex court has aptly observed that the renewable sources for generating electricity including wind and solar power must be utilised, adding that prices of petrol, diesel, petroleum products, etc have been invariably fixed by OGRA arbitrarily without taking into consideration the rate in the international market. Therefore, in future, the apex court ruled, "all necessary steps shall be taken in this behalf to fix the prices strictly in accordance with the prevailing rates in the international market." Needless to say this command is binding under Article 189 of the Constitution and if not implemented will attract contempt of the court.

Regarding supply of gas at subsidised rates to the fertilisers, the court ruled, "As far as supply of gas at subsidised rates to the fertilizer companies are concerned, it may continue but at the same time there must be a policy to ensure that fertilizers like urea etc is sold in the market to the farmers at a subsidised rate...However, as far as captive power plants are concerned, the policy must be revised and without any justification they cannot be allowed supply of gas to produce electricity because they supply electricity at much higher than the NEPRA rate instead of subsidised rate to NTDC."

It is held by the apex court that NEPRA has failed to perform its duties in accordance with the Regulation of Generation, Transmission and Distribution of Electric Power Act, 1997. The judgement says without any unnecessary interference, NEPRA must watch interest of stakeholders/consumers while determining the tariff of electricity and opportunity of hearing must be ensured to all concerned. The court while referring to issuance of licences to CNG stations observed that an exercise has also been undertaken to inquire into the grant of licenses to the various CNG stations. The apex court held that such licences were prima facie unauthorisedly issued from time to time and this aspect of the case was to be heard along with the case of implementation in the case of appointment of Chairman OGRA "and the Court shall decide it on the basis of evidence recorded by the Federal Investigation Agency (FIA) independently".

The judgement of Supreme Court exposes the real malady faced by Pakistan. Rampant corruption in all spheres of governance coupled with lack of will to tax the rich. On the one hand, our incompetent and corrupt rulers are not interested in collecting income tax from the rich and mighty, and on the other have imposed exorbitant sales tax on CNG. Rich absentee landlords conveniently remain outside the tax net, while the poor are paying 16% to 17% GST on items of daily use. Our rulers are playing havoc with the economy by giving extraordinary tax concessions to the rich and levying exorbitant indirect taxes on the poor as well enhancing the prices of utilities and POL prices beyond the capacity of the income of vast majority of the population.

Incompetent, corrupt and inefficient tax machinery suits the rulers, who are the real culprits behind 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 enforcing income tax compliance on the part of the rich. Once it is done, then Federal Board of Revenue must resort to tax audits on a war footing, targeting all those who pay taxes but under-file massively (including government servants), and tax 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 catching those outside the tax net all together (this would also help quantify the extent of under-filing).

The real tax potential 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 tax revenue of even Rs. 5 to 6 trillion in the coming three years, our reliance on domestic and foreign loans can decrease significantly. This is, however, not possible under the present regime that is brazenly protecting tax evaders—**Nawaz Sharif & cronyism**, *Business Recorder*, December 6, 2013.

Taiwan

Taiwan approves Pilot Free Economic zone plans

President Ma Ying-jeou has given his approval to the second stage of the pilot free economic zones (FEZs) that are being established in Taiwan as part of its strategy to open up the island's economy through regulatory easing and open market access.

Taiwan's target in establishing its FEZs is to liberalize its trade, and upgrade its industrial structure, as an initial stage towards the bilateral and regional free trade treaties which are the Government's ultimate goal. The first phase earlier this year started with five free trade port zones – at Keelung, Taipei, Kaohsiung, Taichung and Suao Harbors.

High valued-added industries, such as international health care, education, financial services, agricultural processing and logistics, are the types of business activity to be promoted now within the FEZs. The FEZs will relax tax regulations on the duty-free imports and exports of raw materials, goods and services, and have fewer controls and limits on foreign investment into their areas.

According to President Ma, Taiwan remains 10 years adrift of its major trade competitors in terms of trade liberalization, and the FEZs are aimed at rectifying that situation in the shortest possible time. The second stage of their development will require parliamentary approval, the bill for which is expected to be finalized shortly, with approval early next year.

Under the second stage, apart from more regulatory relaxation, Taiwanese companies will be exempt from taxes on net profits from their operations in the FEZs for a three-year period if they continue to invest in the zones, and foreign firms that operate warehouses or process goods in the zones will be exempt from business income tax on all exports and 10 percent of their imports, also for three years.

In addition, during the first three-year period, it has been agreed to provide income tax breaks for employees from overseas, including foreign professionals, working for companies operating in the FEZs. Those employees, and Taiwanese companies investing in the FEZs with earnings from overseas operations, will also be exempted from tax on their dividend income.

With regard to the liberalization aspects of the FEZs, Ma has reiterated that Taiwan has an urgent need to boost its efforts to take part in the current movements towards regional integration.

He is expecting that all preparatory work for Taiwan's joining of the Trans-Pacific Partnership and the Regional Comprehensive Economic Partnership will have been completed by February 2014, so that the Government can press for its inclusion in on-going negotiations. – *Courtesy tax-news.com*

Switzerland

Switzerland to modify Income Withholding Tax Regime

The Swiss Federal Council has launched a consultation on plans to revise the levying of withholding tax at source on income derived from "lucrative" activity. As a result, the number of taxpayers currently taxed at source, and then subject to a subsequent ordinary tax assessment, is due to increase significantly.

Plans to revise the federal laws governing the withholding of tax at source are intended to eliminate existing inequalities vis-à-vis the tax treatment of individuals taxed at source and those subject to ordinary taxation, as well as to ensure compliance with international treaties.

Currently, the income from the lucrative activity of foreign workers living in Switzerland although without a permanent residence permit C (residents), and the income from the lucrative activity of persons neither domiciled nor resident in Switzerland (quasi-residents), are subject to withholding tax at source, with the fiscal amount deducted directly by the employer. Non-residents working internationally are also subjected to withholding tax.

In January 2010, the Swiss Federal Court ruled that although the withholding tax regime is "justified," the provisions nevertheless contravene the agreement on the free circulation of persons, concluded with the European Union. Specifically, the Court insisted that individuals taxed at source and not domiciled in Switzerland, although who realize most of their global income in the Confederation (quasi-residents), are entitled to the same tax deductions as those subject to ordinary taxation in Switzerland. The Federal Council deemed that modifications to Swiss federal law are therefore necessary.

Consequently, the Federal Council has proposed significantly lowering the gross income threshold above which resident taxpayers taxed at source are required to submit a subsequent ordinary tax assessment. The current threshold for direct federal tax and for cantonal and communal tax (with the exception of the canton of Geneva) is CHF120,000 (USD135,287) a year.

In addition, residents taxed at source and whose gross revenue is below the future fixed threshold will also be able to request a subsequent ordinary tax assessment.

Similarly, foreign employees not residing or domiciled in Switzerland will be able to request a subsequent ordinary tax assessment under the plans, provided that most of their universal income is generated in Switzerland (quasi-residents).

Withholding tax at source is nevertheless maintained for all categories of persons concerned. For non-residents, it replaces individual income tax.

By guaranteeing that both residents and quasi-residents are able to request a subsequent ordinary tax assessment, the Federal Council believes that this will guarantee entitlement to the same deductions as those already subject to ordinary taxation.

The consultation is due to end on March 27, 2014. – *Courtesy tax-news.com*

Belgium

Belgium paves way for 'Additional Regional Tax'

On the recommendation of Belgian Finance Minister Koen Geens, the Council of Ministers has approved a bill modifying the country's income tax code (CIR 92), to allow the imposition of an additional regional tax on individual income tax, from 2015.

The additional regional tax is provided for under III/I of the special law from January 16, 1989, relating to the financing of Belgium's Communities and Regions.

Belgium's Special Finance Act for the Communities and Regions has been reformed, expanding the fiscal autonomy of the Regions. Consequently, the Regions will be able to levy additional taxes on a portion of individual income tax, accord tax reductions, apply tax increases and tax reductions, and grant reimbursable tax credits.

Furthermore, the Regions will be given exclusive competencies for certain tax breaks.

The fiscal autonomy granted to the Regions amounts to a quarter of all personal income tax revenues, boosting the share of regionally-determined tax revenues from an average of below 50 percent, to an average of 70 percent, with the highest share in the Flemish Region.

The bill has now been submitted to the State Council for its examination. – *Courtesy tax-news.com*

FBR to investigate exemption certificates worth Rs60bn

The Federal Board of Revenue (FBR) will investigate all exemption certificates issued to importers and manufacturers as a huge sum of around Rs60 billion has been granted under a concessionary regime during the first four months of the current fiscal year, official sources told The News on Tuesday.

The officials said that goods imported during July-October attracted around Rs100 billion in income tax at the import stage against which the tax offices received only Rs40 billion, while a major part of the amount was drained in exemptions and concessions.

According to the data, around Rs35 billion was allowed exemption against the import of crude petroleum and petroleum products imported by refineries and oil marketing companies.

Tax managers had already submitted their suggestions to withdraw concessions of income tax and withholding tax levy on import of petroleum products and crude oil to boost revenue collection.

At present, oil marketing companies and various refineries are enjoying concessions for depositing payment of income tax at import under Section 148 of the Income Tax Ordinance, 2001. The tax managers estimated around Rs50 billion could be collected in the remaining months of the current fiscal year in case the concession is withdrawn.

Apart from Rs35 billion exemptions allowed on crude oil imports, another Rs25 billion has been granted through certificates issued by the commissioners Inland Revenue or available under the Second Schedule of the Income Tax Ordinance, 2001.

The officials said that the FBR is considering to revisit all the exemption certificates issued by the Inland Revenue offices and find out that exemptions granted through certificates were as per the law.

The FBR has issued a large number of statutory regulatory orders (SROs) on exemption / concession, allowing manufacturers to import raw materials and machinery for their manufacturing activities at lower tax rates, which are subject to the Income Tax Ordinance, 2001 or certificates issued by the commissioners.

The officials said that several cases were reported where certificates were found either fake or importers in the guise of manufacturers obtained certificates.

They said that now the FBR is going to scrutinise the certificates issued to the manufacturers or industrial setups for their concessionary imports and their actual requirement.

They said that the FBR will also analyse whether or not the import by commercial importers was taxed at 5.5 percent.

Previously, the certificates were issued for three months but through a circular issued in November, the validity had been extended to six months.

The concessionary regime in Pakistan has badly dented revenue collection over the years, as exemptions worth Rs240 billion were granted during 2012-13 as against Rs206 billion in the preceding fiscal year.

The officials said that the revenue body is also in the process of eliminating the exemptions and concessions allowed in the income tax, sales tax and customs duty to streamline revenue collection, which is much lower against the expenditures of the country. – *Courtesy International The News*

Ogra issues notification of CNG new prices

The Oil and Gas Regulatory Authority (Ogra) has issued notification of new prices of Compressed Natural Gas (CNG) as per the judgment of the apex court, but ostensibly on last day of the deadline given by the apex court.

The Supreme Court on 10th December had declared the collection of additional 9 per cent GST in CNG price as null and void and ordered the Ogra to issue a notification of new prices of CNG within seven days. On finding apex court decision pertaining to suspension of a levy on CNG, the Federal Board of Revenue (FBR) had submitted a review petition with the apex court. However, the honourable court has so far not granted stay order to the central revenue generation body (FBR) that was found worried to some extent over the decision of suspension of 9 percent GST in CNG price by the SC. According to Ogra's notification pertaining to new prices of cheap fuel (CNG) for above three million vehicles, new price of CNG for Region-I is Rs74.25/kg while Rs66.14/kg for Region-II. New prices have been notified as per the judgment of Supreme Court.

Interestingly, Ogra has issued notification of new prices of CNG on the day when the given limit of SC for notification was set to expiry. So far it had taken advantage of given limit of the SC pertain to issue the notification of CNG prices. The apex court in its judgment had ordered the authority (Nepra) to issue notification of new prices of CNG within seven days. Well-informed sources earlier told that high-ups at the Federal Board of Revenue have verbally asked the top guns of the regulatory authority not to issue a new notification pertaining to decrease in CNG prices. And, Ogra while succumbing to the pressure of Federal Board of Revenue had not decrease the prices of CNG prior to its expiry date.

They also told that prices of CNG would not witness up to Rs 1.23/kg decrease from if the Supreme Court grants stay order to Federal Board of Revenue (FBR).

Ogra has worked out new prices of CNG and will issue a notification pertain to decrease in the prices of CNG in the light of SC decision if the Supreme Court does not grant stay order to the Federal Board of Revenue, they added.

Currently, the natural gas supply to CNG filling stations is suspended in Punjab following a decision of Sui Northern gas pipelines. Reportedly, CNG filling stations would not find gas during January and February while in March and April they would find gas supply for one day a week. However, the fate of gas supply restoration during the month of December for the CNG filling stations is depend on the demand of gas by domestic and industrial consumers, some power plants, tandoors only. – *Courtesy The Nation*

Sale of mobile phones sans PTA approval blocked

Due to growing security threats and the use of cellular devices in terrorism-related activities, the Pakistan Telecommunications Authority (PTA) has banned the sale of mobile phones without its prior approval, according to a media report.

The report cited a a letter sent to the Federal Board of Revenue (FBR) in which the telecom regulatory authority has directed custom officials not to clear consignments of cellular phones if the importer has not submitted design and IMEI (International Mobile Equipment Identity) details to the PTA.

Importers and manufacturers will now have to submit these specification details to the PTA to get approval under section 29 of the Pakistan Telecommunications (Re-Organisation) Act, 1996.

Under the said law, PTA's verification of individual IMEI numbers of cellular phones has been made essential for all manufacturers and importers of cellular phones. Custom officials will not be allowed to clear shipments of cellular phones that do not have IMEI numbers.

"No terminal equipment shall directly or indirectly be connected to a public switched network unless it has been approved by the Authority or an agency appointed by the Authority in this behalf subject to such conditions as it may impose, including conditions limiting its connection to specified types of telecommunication systems," reads Section 29 of the Telecommunications (Re-Organization) Act 1996.

When contacted, a PTA spokesman confirmed that sale without the PTA's approval of mobile phone type and IMEI number had been prohibited.

He said custom officials and concerned companies have been informed that only those consignments of cellular phones would get clearance at ports which are approved by the PTA.

The official said that importers and cellular phone manufacturers have been bound to provide all technical details of the phones to the national regulator.

Speaking to this scribe, PTA officials said the condition had been previously relaxed in a bid to increase sale of mobile phones. However, the sale of inexpensive, low-quality mobile phones either without unique IMEI numbers or fake IMEI numbers had soared during the past few years.

PTA had taken this strict decision of imposition of ban since cellular phone without IMEI numbers were being widely used in criminal activities and were causing hurdles in maintain law and order.

It is to note here that every mobile phone has an individual IMEI number that is unique to it, and can be conveniently located with the right software. With this number, law enforcement agencies can work with service providers to retrieve stolen phones while service providers can block stolen mobile phones from functioning.

The IMEI number is issued from Spain-based Global System of Mobile Association (GSMA). Billions of mobile phones of different brands being used around the world today are registered with the GSMA. – *Courtesy The Nation*

About 0.8 million tax returns received till December 16: FBR

Shahid Hussain Asad Member Inland Revenue Policy and official spokesman of the Federal Board of Revenue on Tuesday said that the FBR has received about 800,000 returns of income/statements till December 16, 2013, reflecting an encouraging response of the taxpayers after witnessing a declining trend in the past few years.

Commenting on 800,000 returns of income/statements filed till December 16, Shahid Hussain Asad stated that in the past declining trend was observed in filing of returns and statements. However, this trend has been arrested in current year as reflected from latest data of the filing of returns and statements. Now, a sizeable improvement has been witnessed in filing of returns for Tax Year 2013 due to effective campaign launched by the FBR as well as field formations to enforce filing of returns. The highest number of income tax returns has been received for Tax year 2013.

The FBR Member clarified that any taxpayer who does not have the computerised payments receipts (CPRs) dated December 16 could not avail the facility to file income tax returns electronically till December 18, 2013. A press release issued by the FBR on Tuesday said the FBR has received about 800,000 returns of income/statements till December 16, 2013, which are considerably more than the 711,000 returns/statements received last year. In this way, a positive response to the taxpayer facilitation efforts of the government has been witnessed. The number of returns filed this year will further increase, as an appreciable number of income tax returns is in the pipeline, which are being filed to avail the benefits announced by the Prime Minister in his Tax Incentive Package for the business community.

Further, the taxpayers who have been granted extension in filing the returns will also file such returns within a week or two. The returns of companies closing their accounts by 30th June, 2013, are due on 31 December, 2013. In this way, it is expected that about 125,000 more returns (including about 25,000 of companies) will be filed by 31st December, 2013.

This improvement in return filing is due to an aggressive campaign launched by the FBR and its field formations this year which was aimed at education and facilitation of the taxpayers for filing the returns of income. More than 200 Kiosks/TFCs were established throughout Pakistan on important business places/offices/Chambers where efficient staff of FBR was available for guidance and help to the taxpayers. The staff also helped the taxpayers in e-filing their returns whosesoever the taxpayers were not having the computer/net facility or necessary expertise to file returns electronically. The FBR stands committed to provide necessary guidance and facilitation to the taxpayers to discharge their national responsibility, the FBR added. – *Courtesy Business Recorder*

Steel items' export to Afghanistan: 11 big cases of tax fraud transferred to Lahore

The Federal Board of Revenue has transferred tax records of 11 big cases of tax fraud involving fake exports of steel products to Afghanistan, from Peshawar Customs to Lahore, for speedy completion of adjudication proceedings against bogus exporters.

Sources told here on Tuesday that the FIRs were registered against the companies of Lahore, involved in massive tax fraud. The companies have shown fraudulent export of steel products to Afghanistan via customs station Torkham. In order to ensure speedy adjudication process, the FBR has transferred all 11 cases to Customs Adjudication Lahore.

According to details, the Federal Board of Revenue has assigned/transferred to Imran Tariq, Collector (Adjudication), Lahore, all the adjudication cases pertaining to fraudulent export of steel products to Afghanistan via Customs Station Torkham. The FBR has exercised powers conferred under Section 179(2) of the Customs Act, 1969 for speedy adjudication of these cases. The FBR has also directed Collector, Model Customs Collectorate (MCC) Peshawar to send a list of all contravention cases along with case files to the concerned regulatory Collectors under intimation to the Board.

The FBR has further directed Collectors MCC (Appraisement), Lahore/Islamabad and Sialkot to nominate focal persons for ensuring effective defence during the adjudication proceedings by sending comprehensive reports to the Board after each and every hearing in these cases.

The FBR has directed Collector Adjudication, Islamabad/Peshawar to transfer all cases along with case files pertaining to the fraudulent export of steel products to Afghanistan detected by MCC, Peshawar to the said officer for his further necessary action and adjudication. The FBR has directed Collector Adjudication, Lahore to conclude the adjudication within the prescribed time limit as per Customs Act, 1969, the FBR added. – *Courtesy Business Recorder*

No.PRA/Orders.04/2013, Lahore, the 17th December, 2013.– In exercise of the powers conferred under section 84 of the Punjab Sales Tax Act, 2012, the Punjab Revenue Authority is pleased to extend the date of payment of Punjab sales tax and filing of return up to 20th December, 2013 for the tax period of November 2013 for all registered persons including withholding agents. Telecom companies will, however, pay tax and file return as per facility of extended time already available to them under the law.

2013 TRI 2015 (H.C. Del.)

HIGH COURT OF NEW DELHI

Badar Durrez Ahmed and R.V. Easwar, JJ.

CIT
v.
Oriental Structural Engineers Pvt. Ltd.

FACTS/HELD

Section 14A & Rule 8D: Expenditure on acquiring shares out of "commercial expediency" & to earn taxable income cannot be disallowed

1. The assessee borrowed funds and invested Rs 6 crore in shares of subsidiary companies. It claimed that the said subsidiaries were Special Purpose Vehicles (SPVs) formed out of "commercial expediency" in order to obtain contracts from the NHAI and that the SPVs so formed engaged the assessee as contractor to execute the works awarded to them (i.e. SPVs) by the NHAI. It was pointed that the turnover from the execution of the contracts was shown in the P&L A/c. It was claimed that the interest attributable to the investments made by the assessee in the SPVs could not be disallowed u/s 14A read with Rule 8D because it could not be termed as expense /interest incurred for earning exempted income. The CIT(A) and Tribunal (order attached) upheld that assessee's claim and held that as the investments in the shares were made out of "commercial expediency" the expenditure incurred for that purpose could not be disallowed u/s 14A and Rule 8D. On appeal by the department to the High Court HELD dismissing the appeal:

> This is merely a question of fact and does not involve any question of law much less a substantial question of law, as the Tribunal held that the expenses which have been claimed by the assessee were not towards the exempted income

Appeal dismissed.

ITA No. 605 of 2012.

Decided on: 15th January, 2013.

Present at hearing: Sanjeev Sabharwal, Sr. Standing Counsel, for Appellant. Rajat Navet with Prachi V. Sharma, Advocates, for Respondent.

JUDGMENT

This appeal has been preferred by the revenue against the order dated 02.12.2011 passed by the Income Tax Appellate Tribunal, New Delhi in ITA No.4245/Del/2011 in respect of the assessment year 2008-09. The issue before the Tribunal, which is also an issue before us, was whether in the facts and circumstances of the case the Commissioner of Income Tax (Appeals) had erred in restricting the disallowance under section 14A of the Income Tax Act, 1961 to 2% of dividend income of Rs. 20,27,812/-.

It was the contention of the revenue that Rule 8D of the Income Tax Rules, 1962 had not been applied properly in respect of the assessment year 2008-09. This aspect has been considered by the Tribunal in detail and it has observed as under:–

> '6.3 We have carefully considered the submissions and perused the records. We find that Ld. Commissioner of Income Tax (Appeals) has given a finding that only interest of Rs 2,96,731/- was paid on funds utilized for making investments on which exempted income was receivable. Further, Ld. Commissioner of Income Tax (Appeals) has observed that in respect of investment of Rs 6,07,775,000/- made in subsidiary companies as per documents produced before him, they are attributable to commercial expediency, because as per submission made by the assessee, it had to form Special Purpose Vehicles (SPV) in order to obtain contracts from the NHAI and the SPVs so formed engaged the assessee company as contract to execute the works awarded to them (i.e. SPVs) by the NHAI. In its profit and loss account for the year, the assessee has shown the turnover from execution of these contracts and therefore no expense and interest attributable to the investments made by the appellant in the PSVs can be disallowed u/s 14A r.w. Rule 8D because it cannot be termed as expense/interest incurred for earning exempted income. Under the circumstances, Ld. Commissioner of Income Tax (Appeals) is correct in holding that disallowance of a further sum Rs 40,556/- calculated @ 2% of the dividend earned is sufficient. Under the circumstances, we do not find any infirmity in the order of the Ld. Commissioner of Income Tax (Appeals), hence we uphold the same.'

On going through the above observations we are of the view that this is merely a question of fact and does not involve any question of law much less a substantial question of law, as the Tribunal held that the expenses which have been claimed by the assessee were not towards the exempted income. The disallowance, therefore, was rightly limited to a sum of Rs 40,556/-. The question of interpreting Rule 8-D is not in dispute and the only dispute is with regard to facts which have been settled by the Tribunal.

The appeal is dismissed.

INCOME TAX APPELLATE TRIBUNAL
DELHI "E" BENCH, DELHI

A.D. Jain, Judicial Member and Shamim Yahya, Accountant Member

Appeal dismissed.

I.T.A. No. 4245/Del/2011 (Assessment Year : 2008-09)

Decided on: 2nd December, 2011.

Present at hearing: R.S. Negi, Sr. D.R., for Appellant. K.V.S.R. Krishna, CA, for Respondent.

JUDGMENT

Per Shamim Yahya:– (Accountant Member)

This appeal by the Revenue is directed against the order of the Ld. Commissioner of Income Tax (Appeals) dated 30.5.2011 pertaining to assessment year 2008-09.

2. The grounds raised read as under:–

"1. That on the facts and circumstances of the case and in law the Ld. Commissioner of Income Tax (Appeals) has erred in restricting the disallowance u/s 14A to Rs. 40,556/- (@2% of dividend income) and not applying Ruled 8D of the Income Tax Rules which is mandatory from A.Y. 2008-09.

2. That on the facts and circumstances of the case and in law the Ld. Commissioner of Income Tax (Appeals) has erred by ignoring the ratio decided in case of Godrej and Boyce Manufacturing Co. Ltd. DCIT (2010) 234 (Bom.).

3. That on the facts and circumstances of the case and in law the Ld. Commissioner of Income Tax (Appeals) has erred in deleting the disallowance made by the Assessing Officer on account of Director's Travelling without considering whether any identifiable benefit accrued to the business.

4. That on the facts and circumstances of the case and in law the Ld. Commissioner of Income Tax (Appeals) has erred by

ignoring the fact that the assessee did not provide any material to support that the expenditure is a business expense.

5. That on the facts and circumstances of the case and in law the Ld. Commissioner of Income Tax (Appeals) has erred in deleting the disallowance on account of VAT not paid before the due date of filing of the return of income and by ignoring the provisions of section 43B of the IT Act, 1961.

6. That the appellant craves to be allowed to add any fresh grounds of appeal and / or delete or demand any of the grounds of appeal."

3. Apropos disallowance u/s 14A

In this case return of income had filed on 30.9.2008 declaring an income of Rs. 67,14,94,245/-. The assessment was framed u/s 143(3) of the IT Act at an income of Rs. 68,05,79,170/-. In the assessment order Assessing Officer disallowed the expenses related to exempt income u/s 14A r.w. Rule 8D amounting to Rs. 35,85,121/-.

4. Upon assessee's appeal Ld. Commissioner of Income Tax (Appeals) considered the issue and held as under:–

> "I have considered the submission of the appellant and also gone through the observations of the Assessing Officer as contained in the assessment order, as well as the judicial pronouncements on the issue.
>
> It is seen that during the year under consideration even though the appellant company has made borrowings from banks and financial institutions on which it had paid interest, investments in Mutual Funds and Short Term Funds were made out of surplus funds available with the appellant from time to time as per the Bank Statements produced. Only the interest of Rs. 2,96,731/- was paid on funds utilized for making investments on which exempted income was receivable (as admitted by the appellant during the course of appellate proceedings) and hence the same is treated as expense attributable to exempt income.
>
> In respect of investments of Rs. 6,07,775,000/- made in subsidiary companies as per documents produced before me, they are attributable to commercial expediency, because as per submission made by the appellant, it had to form Special Purpose Vehicles (SPVs) in order to obtain contracts from the NHAI and the SPVs so formed engaged the appellant company as contract to execute the works awarded to them (i.e. SPVs) by the NHAI. In its profit and loss account for the year, the appellant has shown the turnover from execution of these contracts and therefore no expense and interest attributable to the investments made by the appellant in the SPVs can be

disallowed u/s 14A r.w. Rule 8D because it cannot be termed as expense /interest incurred for earning exempted income.

In view of the facts mentioned above:–

(i) Interest expenses amounting to Rs. 2,96,731/- have been directly found to be incurred for earning exempt income and hence disallowed u/s 14A.

(ii) Further, the company has earned dividend in respect of investments made and some administrative expenses like management's salary, telephone, stationery, postage expenses, etc. must have been incurred thereon. Keeping in view the aforesaid, I am of the opinion that addition of Rs. 40,556/- calculated @ 2% of the dividend earned has to be made i.e. 2% of Rs. 2,027,812/-. Hence, addition made by the Assessing Officer is upheld to the extent of Rs. 3,37,287/- (Rs. 2,96,731/- + Rs. 40,556/-.) This ground of appeal is partly allowed.

5. Against the above order the Revenue is in appeal before us.

6. We have heard the rival contentions in light of the material produced and precedent relied upon.

6.1 Ld. Departmental Representative relied upon the order of the Assessing Officer.

6.2 Ld. counsel of the assessee supported the order of the Ld. Commissioner of Income Tax (Appeals). He placed reliance upon the Hon'ble Jurisdictional High Court decision in the case of *Maxopp Investment Ltd. vs. C.I.T.* in ITA NBo. 687/2009 wherein vide order dated 18.11.2011 the Hon'ble Jurisdictional High Court has expounded that determination of the amount of expenditure in relation to exempt income under Rule 8D would only come into play when the Assessing Officer rejects the claim of the assessee in this regard. It is further expounded that condition precedent for the Assessing Officer to himself determine the amount of expenditure is that he must record his dissatisfaction with the correctness of the claim of expenditure made by the assessee or with the correctness of the claim made by the assessee that no expenditure has been incurred. It is only when this condition precedent is satisfied that the Assessing Officer is required to determine the amount of expenditure in relation to income not includable in total income in the manner indicated in sub-rule (2) of Rule 8D of the said Rules.

6.3 We have carefully considered the submissions and perused the records. We find that Ld. Commissioner of Income Tax (Appeals) has given a finding that only interest of Rs. 2,96,731/- was paid on funds utilized for making investments on which exempted income was receivable. Further, Ld. Commissioner of Income Tax (Appeals) has observed that in respect of investment of Rs. of Rs. 6,07,775,000/- made in subsidiary companies as per documents produced before him, they are attributable to commercial expediency, because as per submission made by the assessee, it had to form Special Purpose Vehicles (SPVs) in order to obtain contracts from the NHAI and the SPVs so formed engaged the assessee company as contract to execute the works awarded to them (i.e. SPVs) by the NHAI. In its profit and loss account for the year, the assessee has shown the turnover from execution of these contracts and therefore no expense and interest attributable to the investments made by the appellant in the SPVs can be disallowed u/s 14A r.w. Rule 8D because it cannot be termed as expense /interest incurred for earning exempted income. Under the circumstances, Ld. Commissioner of Income Tax (Appeals) is correct in holding that disallowance of a further sum Rs. 40,556/- calculated @2% of the dividend earned is sufficient. Under the circumstances, we do not find any infirmity in the order of the Ld. Commissioner of Income Tax (Appeals), hence, we uphold the same.

7. Apropos next issue Director's Travelling

Assessing Officer on this issue noted that assessee has claimed Director's Travelling of Rs. 21,24,882/-. Assessing Officer observed that from the examination of the details it was observed that for following visits made no correspondence or material has been submitted to the support the expenditure is a business expense.

S.No.	Visits	Expenditure incurred
1.	Mr. K.S. Bakshi, Managing Director Visited London/USA during May/June, 2007	Rs. 2,95,292/-
2.	Mr. K.S. Bakshi, Managing Director Visited USA in June, 2007.	Rs. 41,748/-
	Total	Rs. 3,37,040/

Assessing Officer held that in the absence of proper supporting document for this expenditure, the amount of Rs. 3,37,040/- is disallowed.

8. Before the Ld. Commissioner of Income Tax (Appeals) assessee submitted as under:–

> "In our submission dated 10.8.2010 to Assessing Officer, we have submitted detailed chart in which all relevant information regarding Director's travelling i.e. Name of the Directors, Destination, Purpose of Travelling, Name of the Airways, Bill No., Date and amount were mentioned. All the above details were duly supported by the travelling bills.
>
> Assessing Officer in his order has mentioned that, "…. no correspondence or material has been submitted to support that the expenditure is business expenditure."

> Assessing Officer is wrong in stating that no correspondence or material has been submitted. Probably Assessing Officer has not gone through all the details and supporting properly.
>
> The supporting in regard to Foreign travel expenses disallowed are already submitted in our previous submission dated 17.3.2011."
>
> "The purpose of visit was to attend meeting with senior officials of Leighton Contractors Mauritius for discussions on progress of work in regard to Agra and Indore SPV's."

9. Considering the above Ld. Commissioner of Income Tax (Appeals) held that the foreign travel expenses disallowed by the Assessing Officer was incurred for the purpose of business of the assessee and he has explained both in assessment and appellate stages and the disallowance made by the Assessing Officer was not satisfied and the same was deleted.

10. Against the above order the Revenue is in appeal before us.

11. We have heard both the counsel and perused the records. We find that assessee has given sufficient details regarding the foreign travel expenditure. The disallowance in this regard cannot be sustained. Hence, we do not find any infirmity in the order of the Ld. Commissioner of Income Tax (Appeals) and uphold the same.

12. <u>Apropos next issue disallowance on account of VAT</u>

On this issue Assessing Officer noted as per the Tax Audit Report VAT liability of Rs. 1,51,200/- has not been paid by the assessee company stating that there is refund due to the assessee as per the legal opinion. Assessing Officer held that as the liability has not been paid before the due date of filing of the return the same has to be added to the income of the assessee.

13. Upon assessee's appeal Ld. Commissioner of Income Tax (Appeals) noted the submissions of the assessee as under:–

> "As per Tax Audit Report VAT liability of Rs. 1,51,200/- has not been paid by the assessee. As stated by Assessing Officer in the order, assessee has stated that there is refund due to assessee as per legal opinion and therefore there was no liability outstanding in actual. This liability is in respect of sale of equipment amounting to Rs. 37,80,000/- for which liability was debited to party as recoverable and not debited in P&L A/c. This is to bring to your kind notice that the liability outstanding was regarding A.Y. 2006-07, the details of the case are as follows:-
>
> – Assessee company had received a sum of Rs. 3,04,19,803/- on account of work contract executed and on account of sale of earth moving equipment worth Rs. 37,80,000/- (on which VAT @4% i.e. 1,51,200/- has not been deposited).

- Assessee company had entered into a contract agreement with M/s Simplex Infrastructure Ltd. for executing the construction and development work at Central Park II in the capacity of principal contractor and sub-contractor.
- As per agreement and assignment deed M/s Simplex Infrastructure Ltd. was liable to perform the said agreement.
- It was contended by assessee that, as during the execution of the works property in goods has been transferred only once i.e. at the time of execution of works at the hands of sub contractor i.e. M/s Simplex Infrastructure, hence if the sub contractor has discharged his tax liability in respect of work executed, no tax was payable by the main contractor i.e. assessee company.
- This is to inform you that stand of assessee has been considered and order dated 31.3.2010 u/s. 15(3) of the HVAT has been issued by Excise and Taxation Officer cum Assessing Authority, Gurgaon (East). As per the assessment order issued there was refund due to assessee instead of VAT payable.
- Keeping in view above facts, the disallowance of Rs. 1,51,200/- on account of VAT liability outstanding is erroneous and needs to be deleted."

14. Considering the above, Ld. Commissioner of Income Tax (Appeals) observed that after the order of the Excise and Taxation Officer cum Assessing Authority, there was refund to the assessee in stead of VAT payable. Hence, Ld. Commissioner of Income Tax (Appeals) accepted the contention of the assessee that no disallowance in this regard was called for. Ld. Commissioner of Income Tax (Appeals) also accepted the contention of the assessee that this amount was not claimed in the P&L account. On that account a,lso the disallowance was not called for. Accordingly, Ld. Commissioner of Income Tax (Appeals) deleted the addition.

15. Against the above order the Revenue is in appeal before us.

16. We have heard both the counsel and perused the records. We find that Ld. Commissioner of Income Tax (Appeals) has given a finding that as per order of the Excise and Taxation Officer cum Assessing Authority, there was refund to the assessee instead of VAT payable. Hence, Ld. Commissioner of Income Tax (Appeals) has rightly held that no disallowance in this regard is called for. Accordingly, we do not find any infirmity in the order of the Ld. Commissioner of Income Tax (Appeals) and uphold the same.

17. In the result, the appeal filed by the Revenue stands dismissed.

Order pronounced in the open court on 02/12/2011.
