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Foreign:

Chief Commissioner of Income Tax (CCA), Patna
v.
The State of Bihar through
The Chief Secretary Govt. of Bihar

ITA No.1413/Bang/2010
(Assessment Year 2006-07)

ITA Nos.152 to 156/Vizag/2011
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Constitutional right to 'access to information'

by
Huzaima Bukhari & Dr. Ikramul Haq

> **"Every citizen shall have the right to have access to information in all matters of public importance subject to regulation and reasonable restrictions imposed by law"** — Article 19A, *1973 Constitution of Islamic Republic of Pakistan*

In his eloquent note to the detailed judgement in Constitutional Petitions 77 to 85/89 of 2011 [commonly called Memogate Scandal] released on 12 January 2012, Justice Jawwad S. Khawaja, noted that "most petitioners and respondents, and their learned counsel seem to have ignored or glossed over the significance of this major constitutional change". The learned Judge aptly pointed out, "It is an unfortunate facet of our history that during the 64 years since Pakistan's independence in 1947, the people of Pakistan have been, at times, disserved by a non-inclusive governance paradigm where information critical to them has been withheld from them".

In critical times in history, the learned Judge observed, "the people in quest of the truth have mostly been left with conjectures, rumours and half truths. Concealment of information has, in turn led to a distorted history of the country and to a destabilizing division in the polity". The Legislature, by inserting Article 19A through 18th Constitutional amendment, has "empowered the citizens of Pakistan by making access to information a justiciable right of the People rather than being largesse bestowed by the State at its whims". Article 19A, according to the learned Judge, has "enabled every citizen to become independent of power centres which, heretofore, have been in control of information on matters of public importance".

In this judgement, it has been emphasised that people's right to know the truth about what their government and its functionaries are up to, has now become a fully justiciable and enforceable fundamental inalienable right, enumerated in Chapter II of the Constitution.

Section 3 of the Freedom of Information Ordinance, 2002, says, "Notwithstanding anything contained in any other law for the time being in force, and subject to the provisions of this Ordinance, no requester shall be denied access to any **official record** other than exemptions as provided in Section 15". This statutory right, confined to official record, is narrow in scope. On the contrary, the Constitutional right is wide in its scope and gives **right to access to information in all matters of public importance**. Obviously, the learned counsel from the side of respondents failed to appreciate the true import and scope of Article 19A, and it has rightly been highlighted in the judgement that "….the principle of law is that the fundamental right under Article 19A is a

grant of the Constitution and, therefore, cannot be altered or abridged by a law enacted by Parliament".

The Legislature, after reading the apex Court's judgement elaborating the scope of Article 19A, may feel proud that for the first time it has bestowed on the citizens an unbridled right of access to information. So long as Article 19A is part of the supreme law of the land, nobody, including the apex court, can deny to the citizens their guaranteed fundamental right. There should not be any attempt, as Justice Jawwad S. Khawaja emphasised in his note, to limit or trivialize the scope of such right "through an elitist construction whereby information remains the preserve of those who exercise state power".

The principle laid down by the Supreme Court, having binding force under Article 189 of the Constitution, makes it imperative for the Parliament to pass a comprehensive 'right to information' law. The exercise of constitutional right to access to information in all matters of public importance is necessary for transparency, accountability and good governance—essential elements of democratic dispensation At the heart of this constitutional provision is ensuring accountability of all. Logically, the right to information starts from those who judge and adjudge others.

The starting point of implementation of Article 19A should be making public the declaration of assets, liabilities and taxes by judges and high-ranking civil and military officials. The civil society and media should come forward to force parliament to abolish all laws relating to secrecy and/or immunity and enact a comprehensive right to information legislation in the light of above judgement of the Supreme Court for compulsory disclosure of assets, liabilities and taxes paid by judges, generals and high ranking government officials—at present, such information cannot be obtained under Freedom of Information Ordinance 2002 whereas assets of politicians (though laughable) are notified in the Gazette of Pakistan.

The issue of asset disclosure by judges in India came in limelight when a Right to Information Application (RTI) was filed with the Supreme Court by Mr. Subhash Agarwal. After much debate and legal battles, the government introduced a bill in Parliament providing for asset disclosure of judges, but with a protection clause that the same would not be accessible to the people and that judges would not be made liable for any action on the basis of their disclosure. This led to a commotion in parliament—the MPs rising above party lines, vehemently and collectively condemned this clause, forcing the government to pull out the bill.

In the wake of debate in Parliament and public campaign, a number of High Court judges made their assets public, dissociating themselves from the Chief Justice of India's stand that asset disclosure would lead to harassment of judges at the hands of disgruntled litigants. Eminent former judges and leading jurists joined the civil society—they openly

demanded public declaration of assets by judges. The entire civil society and media, unanimously and vocally, opposed the stance of Chief Justice. Succumbing to opposition—both from inside and outside—the Chief Justice ultimately yielded, announcing that asset declarations of the judges would be placed on official website. Soon thereafter, twenty-one judges of the Supreme Court, including Chief Justice of India K.G. Balakrishnan, declared their assets, giving details of movable and immovable property owned by them and their spouses.

After championing the cause of people's right to information in the above judgement, it is a legitimate expectation of the citizens that as a first step, the honourable judges of Supreme Court and High Courts, like their contemporaries in India, would make public their assets and tax declarations. Right to information of citizens has assumed renewed importance in the wake of Supreme Court's judgement on Article 19A.

Judicious and meaningful exercise of this right can make all the four pillars of the State—Legislation, Judiciary, Executive and Media—accountable to the public at large. Right to information in all matters of public importance, access to official record and free availability of what is owned by privileged classes must be assured as it will help improve governance, transparency and rule of law.

How to overcome fiscal deficit

by
Huzaima Bukhari & Dr. Ikramul Haq

> "It has become a regular feature of Pakistan's fiscal operations that at the time of budget planning, quite an ambitious target is set for FBR tax collection; then it is revised several times during the year and at the end of the year, this revised target is also missed"—**State Bank Annual Report 2010-11**

According to 'First Quarter Report 2011-12' issued by the State Bank of Pakistan, it would be challenging for the government to meet fiscal deficit target of 4.7% of GDP "because it depends on strong growth in tax revenue and auction of 3G licences". The report observes that financing of the deficit remains an issue "as the government cannot mobilise external resources to finance the budget deficit". During the first quarter of the current fiscal year, repayments of external loans were higher than receipts of new loans, resulting in net external financing of negative Rs. 4.4 billion. As a result, the SBP says that all the burden of financing fell on domestic sources.

The SBP has observed that the strong revenue growth in tax revenue during first quarter was largely due to import-related sales tax, which was supported by higher unit value of crude oil and fertilizers during the

quarter, but this gain could be offset by subsidies both on fertilizer and POL in the months ahead. It has cautioned that there is heavy dependence (Rs. 150 billion) on the realisation of Coalition Support Funds (CSF) and 3G licences and the expected surplus of Rs. 125 billion in the provincial balances. The report further observes that "while issuance of 3G licences is scheduled for March 2012, the CSF and provincial surpluses are already lagging behind".

The main issue remains that of raising revenue to the level that reduces our fiscal deficit within safe limits. Federal Board of Revenue (FBR), after showing 27% growth in revenue during the first six months of fiscal year 2011-12, is struggling to maintain this momentum. It has failed to enforce the tax laws. The problem is not with laws, but with **collection**. The tax machinery **collects** *only* from the documented sectors by raising unreasonable and arbitrary demands. Four or five sectors contribute about 80% in total tax revenues. The tax cheats in connivance with unscrupulous tax collectors pocket billions taken from the citizens as sales tax but never deposited in the government treasury—on the top of that they have guts to claim input tax credit on the basis of fake invoices.

The tax gap is increasing as is the size of informal ad underground economy. The finance Minister, instead of cracking down on tax cheats is offering immunities to them through stock exchanges. Section 111(4) of the Income Tax ordinance, 2001 is a permanent whitening scheme. One just needs to hire the services of a money exchange dealer who arranges remittance by taking a small premium. Why then should anybody pay income tax?

Since the government like all previous governments—civil and military alike—is not serious in collecting taxes, this year, Pakistan is destined to suffer a monstrous fiscal deficit of at least one trillion rupees. Our tax-to-GDP ratio of 8.2% is one of the lowest in the world, whereas debt-to-GDP has crossed the critical levels. This disastrous situation requires immediate remedial measures. Time and again, we have mentioned in these columns that real tax potential of Pakistan is not less than Rs. 6-8 trillion. We substantiated this claim with concrete facts and figures, yet FBR's stalwarts say "these are simply unrealistic".

FBR is not willing to collect due taxes for obvious reasons. It is a corrupt organisation and its policies are aimed at corrupting the taxpayers in order to secure their "due share" from them. As per official estimates, two scams alone, namely, missing containers and fraudulent input tax credits have revenue losses, of over Rs. 95 billion. In reality, it is over Rs. 250 billion.

FBR, as usual, is squeezing honest taxpayers to meet this year's target of Rs. 1952 billion—Rs. 840.7 billion was shown as "collection" up to December 2011. This was an inflated figure as advance tax under section 147 of the Income Tax Ordinance, 2001 was taken **in advance**. The natural effect of this figure puffery was shortfall in January 2012.

According to a Press report, for the first time in January 2012, collection slipped into the negative zone as FBR failed to meet the target of Rs. 140 billion fixed for January 2012.

The prevalent tax collection policy of FBR is not only detrimental for economy, business and industry, but is also responsible for widening gulf between the rich and the poor. Those who possess more economic power (income and wealth) are not contributing towards the national exchequer on the basis of the ability-to-pay principle, which is regarded as the most equitable and just method of taxation and emphasized upon primarily for its redistributive role. In Pakistan, the ruling trio—indomitable military-civil complex, corrupt politicians and greedy businessmen—have complete immunity from this principle, which is, in fact, a constitutional obligation of the government—from everybody according to his ability and to everybody according to his work (Article 3). On the contrary, the existing tax system protects the rich and mighty—the establishment and exploitative elements that have complete monopoly over economic resources. There is no political will to tax the privileged classes and consequently Pakistan is forced to spend nearly 60% of taxes collected for debt servicing alone.

Determination of a tax base capable of measuring an individual's ability-to-pay is a major problem of our tax system. This rule is incorporated in the form of progressive rate schedule for personal income tax, estate duty, and property tax worldwide. In Pakistan we have moved from this policy to unequal sacrificial rule where the mighty civil and military bureaucrats (now an integral part of our landed aristocracy by earning State lands as meritorious awards and rewards), rich industrialists and greedy businessmen are paying meagre personal taxes whereas the poor people are compelled to pay sales tax and federal excise duty of 16%. The facts and figures below will establish how we can collect taxes to the tune of Rs. 6-8 trillion under the given economic circumstances without hurting the growth and existing business houses. This is the only way to overcome the burgeoning fiscal deficit and unsustainable internal and external debts.

We have about 114 million mobile users who pay both income tax and sales tax but less than 1.8 million file income tax declarations—if we exclude statements filed by persons falling under presumptive taxes and salaried individuals, the total number of returns filed during 2010 was just 523,208. Majority of mobile users may not have taxable income of Rs 350,000, yet they are burdened with undue liability. On the contrary, filthy rich people just pay a fraction of income tax (withheld at source) on their actual taxable incomes without bothering to file their income tax returns.

If out of total population of 180 million, we have 10 million individuals having taxable income of Rs 1.5 million (this is a very conservative estimate), the total income tax collection at the current rate from them would be Rs. 3750 billion. If we add income tax collected from corporate bodies, other non-individual taxpayers and individuals having income between Rs. 400,000 to Rs. 100,000, the gross figure would be nearly Rs

5000 billion. FBR collected only Rs. 590 billion as income tax during fiscal year 2010-11 and figure for the current fiscal year would be around Rs. 750 billion. This shows a whopping tax gap of Rs. 4275 billion. Failure of FBR can be gauged from the fact that despite aggressive media campaign in 2010 and 2011, it could only get less than 600,000 returns, out of which tax was received from only a little more than 100,000.

Similarly, in sales tax, federal excise and custom duties, due to rampant corruption, the total collection is only fraction of actual potential. In fiscal year 2010-11, FBR collected Rs. 630.5 billion under the sales tax, Rs. 135.7 billion under federal excise duty and Rs. 184.6 billion under custom duties. Total indirect collection of Rs. 905.8 was pathetically low. It should have been at least Rs. 3500 billion. If tax gap of Rs. 2550 in indirect taxes and Rs.4275 in direct taxes is bridged, the total revenue collection of Pakistan would be Rs 8500 billion (Rs 5000 billion direct taxes and Rs 3500 billion indirect taxes). This is even more than Rs. 6-8 trillion that we have estimated in earlier articles.

The figures above show that even without introducing any new taxes, we can easily collect Rs. 6-8 trillion that would change the entire fiscal scene. If we manage to tap real tax potential, there will be enough funds for meeting our day to day expenses, retiring debts and funding development projects for public welfare. By collecting taxes to the tune of Rs. 6-8 trillion, we will certainly be in a position to pay off all our internal and external debts in few years, thus, achieving the cherished goal of becoming a self-reliant nation free from all kinds of foreign political and economic subjugations.

The dream of making Pakistan a self-reliant egalitarian State can never be realized unless the mighty sections of society are taxed and tax policy is used as tool for industrialization—taxing the unproductive sector to divert money to productive sectors. At the same time it is necessary to ensure redistribution of income and wealth through progressive taxation—taxing the rich for the benefit of the poor. At present, we are taxing the poor for the benefit of the rich. This trend must be reversed or the privileged classes would face wrath of masses soon.

Devising equitable tax structure

by
Huzaima Bukhari & Dr. Ikramul Haq

At the time of budget announcement for fiscal year 2010-11, the Federal Board of Revenue (FBR) was assigned the target of Rs. 1667 billion, which was later revised to Rs. 1604 billion and finally slashed to Rs. 1587.7 billion. FBR collected Rs. 1558 billion, out of which direct tax collection was Rs. 602.4 billion and rest came from indirect taxes. If indirect taxes, imposed under the garb of income tax, are excluded from collection of "direct taxes" reported by FBR, income tax

figure would not be more than Rs.400 billion. In other words, rich Pakistanis are paying negligible personal taxes while the burden of indirect taxes on the poor is tremendously burdensome.

The problem with FBR is not only non-collection of real tax potential, which is not less than Rs. 6-8 trillion, but pushing more and more people below the poverty line making a few richer, even more rich. This year, Pakistan is destined to suffer a monstrous fiscal deficit of more than Rs. one trillion, and tax-to-GDP ratio of 8.2%, which is one the lowest in the world, will not improve.

The prevalent tax policies are not only detrimental for economy, business and industry, but are also widening the gulf between the rich and the poor. Those who possess more economic power (income and wealth) are not contributing towards national exchequer on the basis of the ability-to-pay principle, which is regarded as the most equitable and just method of taxation and emphasized upon primarily for its redistributive role.

According to various studies (see the latest report of World Bank), around 42 per cent of our total national income belongs to top 20% of the population—36 million persons have a combined income of $75.6 billion or a per capita income of $2,100 i.e. twice the national average. Nearly 27% of the national income goes to just 18 million people—whose per capita income is $2,700.

Mr. Shahid Javed Burki in his article, '**How rich are the Pakistani rich**', has opined: "the total income of the affluent 1.8 million people is $13.12 billion, or $7,300 per capita, and for the richest 180,000, it is close to $20,000". The super rich 18,000 people have a combined income of $1.31 billion or $72,700 per capita. Since the poorest 10 per cent of the population receives only four per cent of the total income, their income per head is only $400 per annum. These numbers begin to put some substance on the extent of relative deprivation in Pakistan. The richest 40,000 people in the country have combined income equal to that of the poorest 18 million people. The super rich — the 18,000 who make up 0.001 per cent of the population — earn 180 times as much as the poorest 18 million. Or, to put it in another way, the super rich earn in just two days what it takes the poor to earn in one year". On the basis of these figures, income tax collection should have been between Rs. 1500-2000 billion. This confirms not only monstrous tax gap but also complete failure of the State in taxing the rich and mighty.

Non-taxation of rich individuals according to their ability-to-pay is a major problem of our tax system which, in democratic countries, is a main vehicle for equitable distribution of income and wealth through progressive income tax rates, estate duty, and property tax. In Pakistan, tax codes favour the rich classes, including mighty civil and military bureaucrats, who are now an integral part of landed aristocracy by earning State lands as meritorious awards and rewards (sic). The greedy traders having enormous incomes are not paying income tax—courtesy presumptive and capacity taxes that they pass on to the end users. On

the other hand, the poor are subjected to exorbitant sales tax or federal excise duty of 16%.

The great failure of FBR and tax system can be measured from the facts narrated below for fiscal year 2010-11:

1. Out of total collection under the head income tax (Rs. 584 billion), the payment through advance tax and with returns was Rs. 208 billion and under withholding regime was Rs. 358 billion. It means only Rs. 18 billion was collected by creating demands by the officers. Can FBR justify maintaining such a huge machinery for collecting a paltry 3% revenue through audits and investigations?
2. FBR collected Rs. 684.2 billion from sales tax (Rs. 308.7 billion on imports and Rs. 375.5 on domestic supplies), out of which share of petroleum products was about 39%. The contribution of petroleum and telecom sectors in domestic sales tax collection is 60%. This exposes the effectiveness of FBR in implementing sales tax across the board. Resultantly, the gap in collection is nearly 200% and there is also illegal enrichment as sales tax collected on local supplies from the consumers never reaches the government treasury due to unholy alliance between the unscrupulous businessmen and corrupt officials.
3. The gross and net collections from customs duty during fiscal year 2010-11 were Rs. 193.4 billion and Rs. 184.9 billion. Massive leakages and corruption—case of thousands of missing containers is just the tip of the iceberg—deprive the nation of billions of rupees under customs duty alone. Goods once released without any duty and record becomes the main source of untaxed informal economy. The recent study of World Bank suggests that revenue losses under the head of customs were not less than US$ 30 billion.

The figures above confirm that out tax potential is not less than Rs. 6 trillion provided we tax the rich and mighty according to their ability to pay, revamp tax machinery, and eliminate leakages and corruption. Collecting taxes to this extent alone can ensure self-reliance—enough funds for day to day expenses, for development and debt servicing. It is the need of the hour that non-partisan political support is secured in the parliament for collecting taxes to the tune of Rs. 6 trillion. Unless, it is done, we will never be in a position to pay off our internal and external debts. In fact, we will be compelled to keep on borrowing endlessly and suffering beyond imagination in coming days.

For making Pakistan an egalitarian State, the mighty sections of society must be taxed. Fiscal policy should be used for taxing the unproductive sectors to divert money to productive sectors. At the same time, it is necessary to ensure redistribution of income and wealth through progressive taxation—taxing the rich for the benefit of the poor.

An alternative of SRO 821(I)/2011: Tax swap for undocumented sectors

by

Adnan Mufti *

I saw the participants started walking out of the seminar hall as soon as a senior tax official took the floor and began to dilate upon ancient and decades old tales of the 'ongoing' tax reforms and never-ending agonies for the low tax-to-GDP ratio, undocumented economy, expansion of tax base, etc.

Of course, I could not disagree that we regularly hear such notions at public forums; yet, admittedly the Government has not drawn its medium to long term policy to put in place a fair, equitable and progressive tax policy in the country.

So, reluctantly, I followed suit!

We understand collection of due tax is a gigantic task in this country where the parallel economy is considered to be as much as 8-10 times higher than the documented sector.

However, a wired truth is that the Government remains the single largest obstacle in promoting the untaxed wealth flow in the economy.

A classic example of such 'facilitation' is the existence of tax avoidance provisions in tax laws, eg, Section 111 of the Income Tax Ordinance 2001.

Further, all attempts made by the tax machinery to widen the tax net have remained half-hearted and half-baked with a corresponding vacuum being made available to certain sectors/classes of businesses to have an easy exit from such measures.

An example of such an ill-planned and unwilling move was the issuance of SRO 821(I)/2011 dated 6th September 2011 whereby the Federal Board of Revenue (the Board) had made it mandatory for all registered manufacturers, importers and exporters selling taxable or dutiable goods to unregistered persons to an issue invoice containing the “Computerised National Identity Card Number or National Tax Number” of unregistered buyers.

In principle, this scribe backs the government move as it is aimed in tapping the unregistered sectors in tax net.

However, again such an effort was not an equitable proposition for all businesses across the board for the reason that the condition for disclosing buyer's CNIC/NTN was not mandatory for distributor, middlemen, wholesaler and retailer - most of whom are classified as tax evaders in terms of both direct and indirect taxes.

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* The writer is partner, Shekha & Mufti, Chartered Accountants and Honorary Advisor to Karachi Chamber of Commerce and Industry on Sales Tax.

The SRO 821 was strongly opposed by almost all the sector of the industry who termed the move as completely impractical and unrealistic on the pretext that unregistered buyers either refuse to share their NTN/CNIC or switch to some other unregistered seller who does not ask for such details from his customers.

Thus, the above conditionality met with the same fate as that of identical scheme introduced in Year 2009.

Fenced with rampant corruption, inefficiency, incapacity, political interferences and above all - lack of direction, the Board again considered the industry's hue and cry and offered specific exemption to the industry by suspending implementation of the SRO 821(I)/2011 to the most powerful sugar sector.

We are mindful that the undocumented middlemen/distributor in the sugar industry has seized millions of rupees from the Government in the form of income tax and sales tax besides causing irreparable loss to the end consumer.

Nevertheless, the former FBR Chairman Salman Siddique defended such a decision before the Senate Standing Committee on Finance by agreeing that such an exemption was a 'temporary arrangement'.

According to Board's ruling issued in this regard, the implementation of the SRO 821(I)/2011 was suspended to the sugar sector until the finalisation of the discussion between the Board and Pakistan Sugar Mills Association (PSMA).

Later on, upon agitation by other quarters who felt aggrieved for being singled out from the concessionary list, the Board issued another ruling whereby the operation of the SRO 821(I)/2011 was suspended across the board till 31 December 2011.

If we analyse both such directives issued by the Board on the legal touchstone, we understand both of them are in field and appear to be overlapping the implementation of the SRO 821(I)/2011 upon sugar sector.

While on the one hand, w.e.f.

01 January 2012 the Board had made it mandatory for all taxpayers to observe compliance with the requirement of NTN/CNIC; however, on the other hand, the sugar-specific ruling has not been rescinded/superseded by the tax authorities.

Due to this, it appears as if the sugar sector will continue to enjoy immunity from disclosing their buyers' NTN/CNIC, while all other business segments will be bound by the requirements of the SRO 821(I)/2011 w.e.f. 1st January 2012.

It has also been given to understand that necessary changes are in the offing in the electronic filing system to restrain non-compliant taxpayers from reporting sales made to the unregistered without disclosing the buyer's NTN or CNIC.

The proposed measures suggests that the FBR's electronic system will block sales tax and federal excise returns from January 2012 onwards of all those registered manufacturers, importers and exporters who fail to disclose their computerised national identity card numbers or national tax numbers of the unregistered buyers.

Despite all the planned procedures, this scribe strongly believes that they are likely not to deliver the goods for a few key reasons.

Firstly, as long as the law provides refugee to certain classes of businesses from making compliance with the requirements of the SRO 821, the door shall remain open for 'tax planning'.

Secondly, the law cannot put the onus of collecting buyer's CNIC/NTN solely upon the seller of the goods.

Where on the one place, in the current anti-business climate in the country, most of the buyers would refuse to oblige such a request; on the other hand, it is also unlikely that they would provide their correct particulars to the seller.

Resultantly, this exercise can, at best, end up in the issuance of notices by tax department to such persons who actually did not indulge in any buying but whose CNIC/NTN was misused by unscrupulous elements.

At a recent TV talk show, the Member, Inland Revenue FBR agreed with this scribe that chances of misuse of the CNIC/NTN exists if the tax machinery goes ahead with its plan to implement the SRO 821.

The government must decide today: is this what we desire out of such a tedious exercise?

The menace of undocumented and benami business is the root cause of our economic ills.

Undoubtedly, we need to put a strong barrier against such trend.

However, measures akin to the SRO 821 cannot yield the desired results for the Government for the foregoing reasons.

As an alternate, it is recommended that the Government should reintroduce the concept of withholding the sales tax, as was introduced on a trial basis, during the Year 2009.

To make it acceptable to every segment of taxpayers, the following modifications are also suggested in such scheme.

Through amendments in the Sales Tax Special Procedure (Withholding) Rules 2007 (the rules), the Government may make all registered persons, conducting business with an annual turnover of Rs 10 million and above, liable to deduct withholding tax, say @ 1/5th, of the total tax passed onto them by their customers.

In case of purchases of taxable goods from unregistered persons, the withholding of sales tax may be made compulsory @ applicable tax rate, eg, 5%, 16%, 19.5%, 18.5%, 21%, 25% out of the total purchase bill.

After deduction, the balance sum may be paid-off to the concerned seller.

To promote such a scheme and as a reward of such compliance work, the withholding agent should also be offered the claim tax credit of an equivalent sum as has been deducted by him from payment made to unregistered persons.

The corresponding exemption available in the 6th Schedule of the Act of Rs 5 million to the manufacturer and retailer should be restricted to those manufacturers and retailers who sell to businesses making turnover below Rs 10 million annually.

The withholding of the sales tax on purchases may also be made applicable upon taxpayers whose supplies are otherwise exempt or zero-rated under the Act, eg, pharmaceuticals, textiles, etc.

This will help document and promote the economy at a faster path.

Sales tax so deducted may be deposited by the withholding agent in the bank under the relevant head of account by the 15th of the month following the tax period during which payment has been made to the supplier.

If the withholding agent is also registered under the Act or the Federal Excise Act 2005, he shall file the return and deposit the withheld amount of sales tax in the manner as provided under Chapter II of the Sales Tax Rules 2006 along with other tax liability.

However, if the withholding agent is not registered for sales tax or federal excise duty purposes but holds a National Tax Number assigned under the Income Tax Ordinance 2001, he shall file the return electronically as set out in the Annexure to the SRO and deposit the amount deducted at source in the manner as provided for persons filing returns electronically under Rule 18 of the Sales Tax Rules 2006.

The government must understand: for right or wrong reasons, the trade and industry will not accept the responsibility of acquiring the buyers' CNIC/NTN for onward reporting to the state.

However, by swapping such a condition with the withholding tax, the Government will not only increase its revenue but will also compel the unregistered sector to come in the tax net.

Of course, 16% is a significant margin.

Noone would be able to get his sales bill slashed by 16% on a regular basis.

He would follow suit - this time, into the tax net.

Facilitating farming community: GST rate on agri tractors reduced from 16% to 5%

The Federal Board of Revenue (FBR) on Monday announced reduction in the general sales tax (GST) rate from 16 percent to 5 percent on import and supply of agriculture tractors to facilitate the farming community and mechanised agriculture farming in the country.

This concessionary GST rate would remain applicable on the import and supply of agriculture tractors from February 1, 2012 to December 31, 2012. It has been decided that GST rate would be increased in the next two phases, first increase in GST rate would be applicable from January 1, 2013 when this concessionary GST rate would be increased from 5 percent to 10 percent and this increased GST rate would remain applicable till December 31, 2013.

Finally, GST rate on import and supply of tractors would be increased from concessionary rate of 10 percent to a statutory GST rate of 16 percent from January 1, 2014 and this rate would remain applicable for onward imports and supplies of tractors in the country.

The federal government had withdrawn the GST exemption on the agriculture tractors in March 2011 and had levied 16 percent GST on such imports. However, this decision of the government faced criticism within and outside the parliament. This decision was later made part of the Finance Bill 2011 and got approved with the budget 2011-12. Since then, the farming community as well as parliamentarians have been continuously demanding the federal government to withdraw the 16 percent GST imposed on agriculture tractors. This matter was placed before the Economic Coordination Committee of the Cabinet (ECC) and ECC's sub-committee had recommended that owing to withdrawal of tractor financing by the Zarai Taraqiati Bank Limited (ZTBL) the increase in tractor prices occurred. However, later on, the matter was placed before the federal cabinet and a ministerial committee presented its recommendations in the ECC meeting and finally a decision was taken in the ECC meeting to first reduce the GST rate and than gradually increase it to statutory rate of 16 Zarai Traqiati Bank Limited in phases.

According to Statutory Regulation Order (SRO) 79 (i) 2012 issued by the FBR in exercise of powers conferred by Clause (b) of Sub-Section 3 of the Sales Tax Act, 1990, the federal government is to

direct that sales tax shall be charged on agriculture tractors, subject to the conditions and restrictions mentioned in the notification. Agriculture tractors falling under Pakistan Customs Tariff heading 8701 9020 on import and supply GST shall be charged at the reduced rates wherever applicable during the periods mentioned in the notification. The federal government has reduced the GST rate from 16 percent to 5 percent on the import and supply of tractors and this would remain applicable till December 31, 2012. – *Courtesy Daily Times*

Monetary rewards recommended for former FBR chairman, other officials

As the country faces a serious revenue shortfall even to meet its day-to-day expenses, the Federal Board of Revenue (FBR) has recommended millions of rupees rewards for its officials, including a former chairman, for the mega containers scam investigations, which according to custom officials failed to bring any results.

The revenue body recommended rewards and payment of honoraria to 35 officials, including Salman Siddique, former FBR chairman, and some Pakistan Revenue Automated (Private) Limited (PRAL) officials involved in investigations of ISAF containers scam, according to the document made available on Monday.

The Supreme Court of Pakistan in a suo-motu case regarding the massive pilferage of Afghan Transit Trade (ATT) in 2010 issued notices to various stakeholders, including the revenue body.

After preliminary hearings, the apex court on September 30, 2010 directed the Federal Tax Ombudsman (FTO) to conduct probe into the matter and also submit report in the Supreme Court.

The FTO in January 2011 submitted its report to the apex court and concluded that it was impossible for an ATT container to complete a round trip from Karachi to Torkham or Chaman and back to Karachi in eight days.

The FTO estimated that the revenue loss on 7,922 containers was Rs19 billion. Furthermore, based on the benchmark of 10 days, the number of missing containers was worked out at 15,314 containers and the revenue loss was estimated at Rs37 billion.

On the findings of the FTO, the FBR chairman constituted a committee to conduct an inquiry and propose remedial measures.

According to the official document, the probe committee submitted seven progress reports so far to the Supreme Court. The official document mentioned that the estimated loss on containers scam stood at Rs55 billion, in addition to, the loss of revenue on 3,544 containers prima facie concerning NATO and ISAF.

The official document recommending rewards also claimed that the probe committee conducted a study that revealed against 63,264 commercial ATT containers imported during the period February 1 to September 20, 2010 the quantum of such imports in the corresponding period fell to 33,414 containers, registering a fall of approximately 50 percent.

It also claimed that simultaneous diversion of illegal trade to regular import channels of 15 items had contributed to additional revenue of Rs6,706 million at the import stage during the period February-September 20, 2011.

The recommendations were also made on the basis of the Supreme Court of Pakistan remarks in its decision dated July 25, 2011 in the words: "It is highly appreciable that on account of taking interest by the Chairman FBR, ie, Salman Siddique, as well as his team, one of the main source of evading customs duty ie, smuggling, etc, have been controlled and minimised."

Senior officials at Pakistan Customs have reacted to the recommendations, saying that the reward should be given if the probe committee had recovered the losses made to the exchequer.

"Curtailing smuggling and duty evasion are the duties of the FBR," a Customs official said on the condition of anonymity.

According to an estimate, the amount against suggested reward is calculated at Rs40 million and the case had been approved by former chairman Salman Siddique before his retirement.

The list of proposed reward equals to basic salary of number of months included Salman Siddique, FBR chairman, Grade 22, three years; Hafiz Muhammad Anees, Member TPA, Grade 21, two-and-a-half years; and Haroon M K Tareen, Grade 21, two years. The reward also recommended for officials between Grade 4–19 for different number of months.

Meanwhile, six PRAL officials are also proposed for the benefit.

Senior tax managers said that the recommendation is contradicted to the existing laws, saying Unified Reward Rules - 2006, notified with the approval of the prime minister, cash reward is restricted

up to two months basic pay in a financial year to the regular officers and staff (BS-1 to 21) of the FBR or its field formation.

To avoid reward claims, the FBR had further restricted this reward up to 40 percent of the total working strength in case of BS 1 to 16 employees and certain other standards and conditions in the case of officers in BS-17 and above.

The tax managers said that the FBR Act, 2007 override all other relevant laws, had provided unfettered powers to the revenue body to grant reward to the employees and members of the board.

However, after promulgation of the FBR (Amendment) Act, 2011, inserting various provisions, this power has been made subject to the criteria for grant of incentive and reward is to be approved by the Policy Board.

"Hence, no reward can now be sanctioned invoking the provisions of the FBR Act until and unless criteria and performance standards are approved by the Policy Board," according to another official note sent to the FBR chairman.

The Customs officials said that the legal position was clear as getting approval of the Policy Board would take time, therefore, another proposal was submitted to the FBR, which read as: "Based on exceptional performance rendered by the officers and staff in the suo motu case in investigation of ISAF containers scam stood appreciated by the Honorable Supreme Court, a summary for the prime minister may be moved, through the finance minister, for approval of the proposed reward, as a special case."

Despite probe committee efforts claimed by the FBR document, around 785 containers of ATT found missing during the period from January 1, 2011 and December 31, 2011.

According to an official statistics, the Customs officials identified those containers where de-seal was not found in the record, which means those containers left the Karachi Port, but never reached Afghan border or reported at the point of exit. – *Courtesy The News*

FBR clarification welcomed

The Federation of Pakistan Chambers of Commerce and Industry (FPCCI) has appreciated the Federal Board of Revenue (FBR) for clarifying deduction of withholding tax at the import stage, a statement said on Friday. Shakeel Ahmed Dhingra, Vice President (Elect) and Chairman, FPCCI Standing Committee on Liaison

with the FBR, appreciated Shahid Asad, Member Inland Revenue, FBR, for taking immediate action and issuing clarification for charging withholding tax at one percent from commercial, as well as industrial importers, instead of five percent, at the import stage on items specified in SRO 1125(I)/2011 dated December 31, 2011, regarding duty-free import of raw materials for five zero-rated export-oriented sectors, viz textiles, leather, carpets, surgical goods and sports goods. – *Courtesy The News*

Amendments to Scheme of Export Oriented Units: FBR seeks LTUs and RTOs comments

The Federal Board of Revenue has sought comments of the Large Taxpayer Units (LTUs) and Regional Tax Offices (RTOs) on proposed amendments to the Scheme of Export Oriented Units to encourage exports in changing global situation of fabrics/garments markets.

Sources told here on Monday that the FBR is likely to amend the Scheme of Export Oriented Units notified vide SRO No 327(1)/08 after incorporating viewpoint of the LTUs/RTOs.

It has been proposed that upto 5% of the production may be allowed as a B-grade/substandard output which can only be sold in the local market.

Secondly, the criteria for eligibility of this SRO for Export Oriented Units may also include that exports should be 100% of its production to other countries (inclusive up to the 20% supplies for exports) if established on or after July 1, 2007.

According to the revised scheme of Export Oriented Units submitted by exporters to the FBR, the Board since 2008 has introduced the Scheme of Export Oriented Units vide SRO No 327(1)/08.

The underlying idea behind launching this scheme was facilitation for the export-oriented units.

In this respect the relevant SRO 327(1)/08 provides a variety of incentives for such units which include exemption from customs duty, sales tax and federal excise on importing raw materials, plant & machinery, equipment etc with in the parameters duly defined by the FBR.

In this regard, it has been emphasised that special attention may be drawn towards the criteria set out to become eligible to avail

the benefits of this SRO as defined under section-2 para-d of SRO-327(I)/2008 dated March 29, 2008 which is reproduced:

(d) "Export oriented units" includes a small and medium enterprise and mean a manufacturer having in-house manufacturing facility located in the tariff area of Pakistan and licensed as such by the Collector and exporting at least 80% of its production to other countries if established before July 1, 2007; or 100% of its production to other countries if established on or after July 1, 2007, and licensed by the Collector of Customs under rule 3.

Sources said that this criterion restricts the production/disposal of the production of Export Oriented Units within specific pre-defined limits which is hampering the growth of these units as well as other garments stitching export units having not a fabrics manufacturing facility with the changing pattern of new markets.

It may be pointed out that at present there is change in the fabric market, which is favourable for the garment sector.

Now sizeable orders are being received by the value added sector including garments sector from the international market. – *Courtesy Business Recorder*

Goods imported for zero-rated regime: FBR to charge one percent WHT

The Federal Board of Revenue will charge one percent, instead of five percent withholding tax on goods imported for zero rated regime.

According to Shakeel Ahmed Dhingra, Vice President (Elect) and Chairman, FPCCI Standing Committee on Liaison, with efforts of FPCCI, the FBR has clarified that withholding tax will be charged one percent from commercial as well as industrial importers, instead of 5 percent, at import stage on items specified in SRO 1125(I)/2011 dated 31 December 2011 regarding duty-free import of raw material for five zero-rated export oriented sectors - textiles, leather, carpets, surgical goods and sports goods.

Dhingra appreciated Shahid Asad, Member Inland Revenue, FBR for taking immediate action and issuing clarification for charging withholding tax.

He also elaborated that in the absence of Member Inland Revenue FBR, the Customs authorities were charging withholding tax @ 5

percent on the goods imported under SRO 1125(I)/2011 for the zero-rated regime due to wrong interpretation of the law.

However, when Member Inland Revenue was contacted on his return from abroad by Dhingra, he immediately issued the instructions to the concerned authorities for levying 1 percent tax. – *Courtesy Business Recorder*

Sindh government to put CVT, infrastructure tax on automation

After the success story of online collection of sales tax on services, Sindh government has decided in principle to put two more provincial taxes including Capital Value Tax (CVT) and Infrastructure Tax (IT) on automation, sources told on Monday.

Sindh government took this decision in a meeting chaired by Chief Minister Qaim Ali Shah at Chief Minister House a few days back.

Officials of Sindh Revenue Board (SRB), Excise and Taxation, Board of Revenue, Finance Department and others attended this meeting.

Officials of SRB briefed the Chief Minister saying that Sindh government can put more taxes on automation ,which would bring more transparency in the collection of taxes.

They offered the services of SRB in this regard, sources said.

The CM agreed with the briefing of SRB officials and accepted their proposal to provide technical assistance to concerned departments in order to put two provincial taxes including CVT and IT on the automation, sources said.

After the approval by the competent authority, the SRB officials started their work to put the two taxes on automation which will be completed very soon.

Sources said that after the launching of said computerised system, SRB would play the role of technical co-co-ordinator on this subject while, the collection would be done by the mother departments--Board of Revenue and Excise and Taxation.

So far, yearly collection of CVT is about Rs 2 billion while the Excise and Taxation department's yearly collection is about Rs 11 billion in the head of Infrastructure tax, sources informed.

With putting both taxes on computerised system, the collection would be increased and it would be more transparent because

human hand's involvement would be reduced at highest level, sources claimed.

Sources expressed fear that Board of Revenue and Excise and Taxation are very much lucrative departments in the eyes of officers of Sindh government so that when they will hear about this new decision they would definitely create hurdles in the way of putting taxes on automation.

It is reported that a large number of officers of other departments are working in said departments on deputation basis because lucrative jobs, sources added. – *Courtesy Business Recorder*

Iran asked to reduce levy on textile, abolish ban on citrus

Prominent Pakistani businessmen, on Tuesday, asked the Iranian government to reduce duty on Pakistani textiles and abolish ban on its citrus to increase bilateral trade volume, as Iran and Pakistan are strategically very important to each other.

The Federation of Pakistan Chambers of Commerce and Industry (FPCCI), Islamabad Chamber of Commerce and Industry (ICCI) and Pak-Iran Business Council met with an Iranian delegation to discuss ways to enhance trade links between Iran and Pakistan.

The participants suggested that prominent traders of both the countries should come forward with different proposals to eliminate trade barriers and improve regional coordination.

Deputy Minister and Head of Trade Promotion Department of Iran, Safdal said that trade between Iran and Pakistan should be increased further, and the government of Iran welcomes any step taken by the traders of both the countries in this regard.

FPCCI President Haji Ghulam Ali said, “We welcome the decision of Iran regarding the opening of the biggest commercial bank in Pakistan and the availability of the facility of letter of credit (LC)”. He further said that Pakistan and Iran share a 900-kilometers long common border and there is a need to explore more land routes and a common railway line between Iran and Pakistan in order to enhance the bilateral trade.

In his address, Pak-Iran Business Council Chairman Tariq Sayeed said the overall trade volume between Iran and Pakistan is worth $300 million which needs to be increased on immediate basis. “We need to increase our exports and make essential arrangements to reduce smuggling,” the chairman said. – *Courtesy The News*

Revenue body recovers Rs6.5bn from banks

The Federal Board of Revenue (FBR) has recovered Rs6.5 billion through scrutiny of accounts submitted by various financial institutions for the tax year 2011.

"The amount was recovered against avoidance of taxes in the accounts by showing inappropriate expenses," a FBR official said while requesting anonymity. The audit was conducted under mandatory assessment and normal audit sections provided in Income Tax Ordinance, 2001, the official added.

The FBR is striving hard to enhance the revenue collection for the current fiscal year due to mammoth revenue collection target. The FBR has collected Rs964 billion during the first seven months of current fiscal year and needs further Rs988 billion in the remaining five months to meet the target of Rs1952 billion.

"The audits of banks were also finalised to generate sizeable revenue for the month of February 2012," the official said. "The banks are normally prime target for revenue generation," the official added.

The revenue body had faced shortfall of Rs16 billion in collection of January 2012 as it was at Rs124 billion against the target of Rs140 billion.

FBR sources said that the revenue body was also trying to recover further amount from banks under the head of 15 percent surcharge as several banks were still contesting the applicability of surcharge levied in March 2011.

"An amount of Rs1.5 billion is expected to recover from banks under the head of 15 percent income tax surcharge," according to a source in FBR.

The FBR during this year also initiated audit of other sectors of the economy of multiple years to reduce the backlog and generate revenue for the exchequer.

On of the major steps taken by the FBR during recent years for broadening the tax base and collection as well was monitoring of withholding tax deducted by banks.

The FBR sources said that the recovery from banks was not included the amount under monitoring of withholding tax.

In the last fiscal year, the revenue body had initiated the monitoring of withholding tax of banks and investigated salaries,

expenditures and profit on debts, which yielded around Rs5 billion to the national exchequer.

According to FBR officials the revenue body intended to launch forensic audit of cash withdrawal through banks, the major source of withholding tax to identify discrepancies in collection of withholding tax. They said that under this exercise, the FBR would select bank branches for audit and tax officials would conduct detailed scrutiny of transactions. – *Courtesy The News*

SECP issues Shariah audit mechanism for modarabas

A system has been finalised under the guidance of the SECP Religious Board that will ensure and verify that the business transactions undertaken by modarabas are in accordance with the pattern of Islamic banks in compliance with injunctions of Islam.

This was stated by the Chairman, NBFI & Modaraba Association of Pakistan Basheer A. Chowdry in a statement here Tuesday. Dilating on further details, he said after an in-depth consultative process undertaken by SECP in which most of the modarabas participated, a formal mechanism namely Shariah Compliance and Shariah Audit Mechanism (SCSAM) is being introduced to further enhance the quality of existing compliance and eliminating the risk or possibility of any inadvertent violation of Shariah principles by the Modarabas.

A detailed Shariah Compliance and Shariah Audit Mechanism (SCASM) has been issued by Registrar Modarabas SECP which provides an elaborate framework for compliance. Chowdry said that it also prescribes the screening process for the investments in shares/securities to maintain the trust of the stakeholders in the Islamic financial system.

He pointed out that the modaraba already execute all their contracts and business modules according to the patterns approved by the Religious Board. It also lays down the process for purifications of dividend income. Under this plan, investment by the modaraba in the shares and securities shall only be made in the companies screened by the Shariah advisor of the association in accordance with the screening procedure. – *Courtesy The News*

Economy heading towards unsustainable, risky path Says political considerations are a major hurdle in implementing reforms

The International Monetary Fund (IMF) in its country report on Pakistan, which was released on Wednesday, has asked Islamabad to raise general sales tax rate, re-introduce special excise duty, income tax surcharge along with host of other measures to avoid full-fledge brown out of economy towards the risky path.

The IMF's report conceded both sides agreed that "political constraints to reform had been binding for some time." It said political considerations of the government are a major hurdle in the way of implementing reforms.

The Fund cautioned that the authorities' policy mix was leading the economy down an unsustainable and risky path. High fiscal deficits were crowding out the private sector and hurting growth, monetary policy was accommodating the deficits and keeping inflation high, while the external position was deteriorating significantly, in part reflecting global developments.

Pakistan's fundamental problems are well known, the report said and added that governance and institutional problems were undermining the country's fiscal position. The complexity of fiscal management has recently been compounded by fiscal decentralisation in the wake of 7th NFC Award and the 18th constitutional amendment.

The report said unpredictable and widespread power outages are stifling growth, adding power sector subsidies, which are poorly targeted, have squeezed out social spending. Large public sector enterprises with soft budget constraints continue to sap fiscal resources, as do the government's commodity operations. Meanwhile, arrears in the energy sector undermine budget discipline and are clogging up the financial system.

It said solutions to these problems, however, require politically difficult decisions. Pakistani authorities recognise that country's macroeconomic problems have microeconomic and institutional causes that need to be addressed to achieve higher, inclusive growth. A fundamental break with the past is needed, and this will require a national consensus on a strategy to revive economic growth, along the lines of the National Growth Strategy (NGS).

The authorities acknowledged the risks in the months ahead, but also noted some mitigating factors, such as continued strong remittances inflows and increased tax collection in 2011/12.

They nevertheless agreed on the need to prepare a plan to mitigate risks.

Beyond the short term, the report mentioned that there was an agreement on the importance of putting together a home-grown reform strategy for the next several years, based on a broad consensus, with the objective of raising inclusive growth.

The Fund assessed that if the government remained unable to take required measures on revenue mobilisation side coupled with reducing the expenditures the budget deficit could hike to 7 percent of GDP or Rs 1,443 billion by end June 2012.

The Fund staff proposed a set of measures to build buffers and boost confidence, and cap the 2011/12 deficit at 5.7 percent of GDP.

The government could use a combination of spending and revenue measures that include: tightening non-wage current government spending, including the reduction of non-power subsidies (e.g., wheat, fertilisers); reintroducing the special excise duty and income, tax surcharge; and raising the sales tax rate.

At the same time, efforts should be made to minimise the electricity subsidies and keep provincial budgets in surplus.

In the medium term, the IMF prescribed for bringing improvements in economic health by doing further fiscal adjustment, based on structural measures. With gradual deficit reduction and continued low borrowing costs (relative to inflation) over the medium term, Pakistan’s public debt would be sustainable, but the debt level is high, making it vulnerable to interest rate or exchange rate shocks. The country’s debt to GDP ratio is project to hover around over 61.7 percent.

In addition, given financing constraints, lower deficits would reduce crowding-out and make more bank credit available for private-sector investment, it added. – *Courtesy The News*

Details of un-registered buyers: Karachi LTU issues controversial notices to big companies

Large Taxpayers Unit (LTU) Karachi has issued notices to big companies and corporate entities seeking details of their un-registered buyers retrospectively and encompassing the period 2010-11, which is totally against the provisions of SRO821(I)/2011, applicable from January 2012.

It is learnt on Wednesday that a number of sales taxpayers registered with LTU Karachi, were served with the notices contending that sales tax return of the units for the period ended June 2011 have been reviewed and element of sales to un-registered person were found, accordingly they were required to furnish details of National Tax Number (NTN) and other particulars of such buyers under section 176 of the Income Tax Ordinance 2001.

In case of non-compliance, the LTU Karachi has cautioned that penal action will be taken against the non-compliant taxpayers under section 182 of the Income Tax Ordinance 2001.

The show cause notices of the LTU Karachi have also directed the taxpayers to provide complete addresses and other particulars of un-registered buyers and distributors etc.

Commenting on notices of LTU Karachi, Arshad Shehzad, a prominent sales tax expert of Karachi told here on Wednesday that issuance of notices by LTU Karachi has sparked new debate over controversial notification 821.

The FBR has implemented the SRO.821(I)/2011 from January 2012, but the LTU Karachi has directed the corporate sector registered with them to provide details of their un-registered buyers for the period of July 1, 2010 to June 30, 2011.

Legally, the SRO.821(I)/2011 for the documentation of the un-registered buyers cannot be enforced retrospectively.

The SRO.821(I)/2011 has been implemented from January 2012 to be applicable on the sales tax returns to be filed in February 2012.

Mandatory provision for furnishing NTN/ CNIC of unregistered buyers were recently made part of the sales tax law through notification 821(I)/2011 dated 6th September 2011.

The said notification was overwhelmingly criticised by the trade and industry, thus thereafter forced the government to hold the notification in abeyance till December 31, 2011.

The implementation of the notification is yet not decided and generally there are perception for it's extension till next Finance Bill.

When the Karachi based tax experts was questioned about such notices, he replied that under such situation where government is in the process of dialogue with trade and industry for bringing some modalities to tap the un-registered segment of the tax net, issuance of these sorts of notices may directly hurt the efforts of the policy makers.

He was in the view that legally under the Sales Tax Act, the sales tax payers are not obliged prior to issuance of notification 821(I)/211 to report details of NTN, CNIC or any other particulars of such buyers who are not registered.

In his opinion issuance of such notices creates further resentment among the registered taxpayers community to accept any such condition.

He further said that government should not create hassle and botheration for registered taxpayer, they must be treated them as an asset.

Any damage of their confidence and faith on the tax management may back fire rather any achievement, Arshad Shehzad added. – *Courtesy Business Recorder*

FBR agreed to all proposals on CGT: SECP chief

The Chairman of Securities and Exchange Commission of Pakistan (SECP), Muhammad Ali, categorically said on Wednesday that the Federal Board of Revenue (FBR) has agreed to all proposals of the SECP on capital gain tax (CGT), and revision in the CGT regime cannot be used for whitening the illegal money by making investment in the stock markets.

Sharing latest update on the proposed CGT mechanism of the SECP, he told media here on Wednesday that the revised CGT regime could not be used for whitening illegal money of stock market investors.

Only legal money made during CGT exemption period of the last 36 years would be facilitated to be brought in to the stock market up to 2014.

Strongly dispelling the impression of illegal investment in the market, the SECP Chairman clarified that there is no chance of

investment of illegal money in the stock exchanges due to stringent requirements following effective customer due diligence/know your customer policies in the capital markets.

Even if section 111 of Income Tax Ordinance, 2001, requiring unexplained income or assets would be deferred for funds invested in capital markets till June 30, 2014, but laws of other enforcement agencies like FIA, NAB would be used to check any kind of investment on the apprehensions of illegal money.

He said that during finalising the revision in CGT regime, major concerns have been addressed.

Although investors would be exempted from explaining source of investment under section 111 of the Income Tax Ordinance, 2001, the provisions of the laws of the National Accountability Bureau (NAB), Anti-Narcotics Force (ANF), Federal Investigation Agency and other national institutions would continue to apply on the source of investment.

Muhammad Ali explained in detail three CGT-related concerns highlighted by media, including investment of illegal money in stock market, people may use CGT scheme for whitening of illegal money, and exemption from source of investment could lead to illegal money coming to the market.

Clarifying these concerns, the SECP Chairman said that measures that have been taken to address these issues include that there would be complete due diligence of the investors, and last week the SECP had tightened its procedures in this regard.

He ruled out any chance of misuse of the scheme for whitening illegal money through revised CGT regime and said that minimum holding period, which could be 3 months to 6 months, would address this issues and there would be more risk in minimum holding period for the investors in stock market than investment in other instruments available for whitening the illegal money.

Why anybody would come to stock market to legalise black money in the presence of cheap instruments used for legalisation of the undisclosed and unexplained investments? There are easy ways available to the public to legalise money on mere payment of 2 percent of the amount, like prize bonds, etc.

In the presence of such instruments, there is no need for any person to come to the stock market for legalisation of illegal money where high risk is involved in capital market investment.

In a certain withholding period of shares at stock market, the value of shares may go up or down involving high risk for the investors.

Due to involvement of price risk factor why any investor would use the channel of stock market for whitening the money in the presence of other options available for this purpose, the SECP Chairman further explained.

When asked how the SECP would encourage documentation while availing exemption from disclosing source of investment in stock market under section 111 of the Ordinance 2001, he responded that the exemption from section 111 of the Income Tax Ordinance 2001 would be available up to June 30, 2014.

After this period, source of investment would be probed by the tax department under the new CGT scheme.

Muhammad Ali said that the exemption from the CGT was available to the investors for the last 36 years, and investors have earned profits and created wealth from the earnings of investment in stocks.

Billions of rupees made during these 36 years from stock market were legal.

However, these have not been documented and new CGT regime would help document it for the first time.

The wealth created by the stock market investors was legal and official because there was no CGT applicable in the past.

The wealth was legal but not documented in the books of income tax department.

The investors did not declare this wealth in their income tax returns.

Neither the investors knew to file their income tax returns in the past nor did tax department pursue the investors to submit the returns.

The investors have not cancelled their wealth but they were not asked to file their income tax returns.

When asked about FBR's objection on declaring NCCPL as withholding agent, the SECP Chairman said that the FBR has no objection on declaring National Clearing Company of Pakistan (NCCPL) as a withholding agent to deduct and deposit the CGT from investors' transactions.

The FBR is not opposing proposal of working of NCCPL as withholding agent.

The SECP and the FBR are closing working for the finalisation of the CGT scheme to achieve four major objectives ie documentation of economy, broadening the tax base and expanding the tax net, generation of maximum revenue, and revival of capital markets.

The implementation date of the new scheme is April 2012.

In this connection, there is no need to go to the Parliament for revising the CGT collection procedure.

The FBR will amend the Income Tax Rules on CGT to introduce all necessary changes required for making the new system operational.

For declaring the NCCPL as withholding agent, this could be done through an Ordinance.

There would be also requirement of amendments in the NCCPL regulations for withholding and deduction of the due amount of tax by NCCPL being withholding agent.

There is also a need to change the systems of the NCCPL for implementation of the whole scheme for deduction and deposit of the due amount of tax.

To simplify calculation and achieve smooth implementation of CGT, the SECP has proposed to freeze the CGT rate at existing levels.

Any further amendment in the Income Tax Ordinance 2001 for freezing the CGT rates up to June 30, 2014 could be done through Finance Act 2012 onwards.

He further said that the revision in CGT regime has been fully endorsed by the FBR as it has been finalised in consultation with its top officials and it would help documentation of money invested in stock market, help stop tax avoidance and tax evasion.

Explaining the functioning of the new system of the CGT, the SECP Chairman further elaborated that the taxpayers would be required to file income tax returns under the new scheme and the deducted tax would be dully reflected in the returns.

The SECP has further proposed that NCCPL shall act as a withholding agent to deduct and deposit the CGT from investors' transactions.

The NCCPL shall also provide investor-wise monthly report of CGT deducted and deposited for each investor to FBR and issue a certificate to the investor of the amount deducted.

The investor will file tax return, including the CGT deposited, based on the certificate provided by NCCPL.

The NCCPL would be declared as withholding agent to document all transactions of stock market for the CGT purposes.

In this way, all investments of the stock market would be documented for the FBR.

No investor can escape from the system of the NCCPL and this would be the most appropriate way to deduct tax on all stock market transactions.

When asked about the status of withholding tax on stock market transactions, Muhammad Ali said that the withholding tax would be abolished under the new scheme as tax would be collected on profit and not on transactions.

In other words, the transaction-based tax would not be applicable under the new CGT regime.

Following imposition of the CGT on stock market, the tax collection from stock market has been drastically reduced from Rs 4-5 billion per annum to only Rs 300 million.

During the last three years, the stock market has been destroyed and investors are not interested in making investment in capital market due to sudden imposition of the CGT.

The listing of new companies on the stock exchanges has also been decreased due to the CGT.

The announcement of the Minister of Finance on the CGT at Karachi had a positive impact on the market and the trading volume has started increasing at the stock exchanges.

The SECP wanted to place a CGT collection system which would ensure increase in trading volumes without comprising revenue collection, the SECP Chairman explained.

He further highlighted that when CDC account would be opened, all bank requirements would apply on such account, and there is no logic in fearing that illegal money would come into the stock market.

He also dispelled the impression that revision in CGT regime would negate any proposal of Financial Action Task Force of the

Anti-Money Laundering, and said that as a safeguard, all proposals of FATF have been made part of the revised scheme.

The SECP Chairman explained that all transactions recorded by the National Clearing Agency would help stop tax evasion and tax avoidance.

The CGT would be applicable on profit only as against the earlier practice of profit and loss both.

It has been proposed that the rate of tax shall be 10 percent on capital gains arising on securities held for a period up to six months, and 8 percent on capital gain arising on securities held for a period above six months to one year for investments made in the stock markets up to 2014.

He said that before imposition of CGT, tax collection from stock market was Rs 5 billion.

That has came down to Rs 300-400 million.

The revision in CGT regime would help bring in huge investment back into the stock market and this would help document the wealth, broaden the tax base, and increase in the tax proceeds.

The major target that would be achieved through this revision in CGT regime is to revive the stock market, and help businesses to arrange capital required for their growth.

The average turnover of the stock market has declined after imposition of the CGT and there is an effort to get it back to its earlier turnover.

Some 500 million shares were traded in the stock market at the time when market was performing well and now these volumes have declined to 150 million shares.

The SECP wants to bring the volume back to 500 million shares, or even higher, and this would result in higher tax collection from stock market.

He said that imposing minimum tax on money earned from other sectors, if invested in stock market after the revision of CGT regime, would make investors stay away from the market.

He also said that placing any kind of cap on such kind of investment in stock market would be against the spirit of the stock market.

Explaining the reason for introducing revised CGT regime from April 1, 2012, the SECP Chairman said that SECP, FBR and NCA

have to revise their rules and regulations and these could be revised and implemented during a transition period of the last three months of the ongoing fiscal year (2011-12). – *Courtesy Business Recorder*

Sales tax refund process: FTO underlines need to solve maladministration problem

Federal Tax Ombudsman (FTO) has found the issue of pending sales tax refund claims reconciled, but stressed the need of solving maladministration problem in the sale tax refund process.

According to textile sources, the FTO in reply to complaints lodged by Pakistan Apparel Forum and Site Association of Industry against the Revenue Division, Government of Pakistan regarding unsettled issue of sales tax refund claims, has showed concerns over the maladministration, which is causing problems in expeditious disposal of the refund claims.

Both the associations had filed a list of sales tax refund claims with the FTO under section 10 of the Sales Tax Act 1990 on the basis of long standing pending tax cases.

Pakistan Apparel Forum had submitted 160 pending claims and SITE association 45 claims amounting to Rs 974.642 million and Rs 288.322 million, respectively, sources said.

In response to the complaints, the FTO conducted a probe to ascertain the facts and status of the issue, they said.

They added that the Revenue Department stated the Regional Tax Office had sanctioned 70 cases against the total 169 cases of Pakistan Apparel Forum.

Whereas, it said, 90 percent claims of the Site association had already been settled.

However, the department still wanted the associations to provide it with the complete monthly details of the refund claims along with supporting evidences to settle the issue as per the law, sources said.

They said in the case of Pakistan Apparel Forum, the department had accepted 67 claims were pending amounting to Rs 410.215 millions but the forum said the number of claims were 77 with outstanding amount of Rs 559.307 million.

Similarly, they said, after reconciliation meetings, the claims of Site association reduced to 15 with an amount of Rs 57.997 million due to be refunded.

In its findings, the FTO said that the maladministration had made the process difficult for disposing of the sales tax refund cases, despite the issue was settled after the intervention of the office.

The FTO recommends the Federal Board of Revenue (FBR) to direct chief commissioners to clear all the more than two months old pending sales tax refund claims as per law within four weeks.

The office has asked FBR to put in place an efficient and fool-proof mechanism of expeditious disposal of bona fide refund claims.

The office has also asked Pakistan Apparel Forum and Site Association to file a monthly statement with registrar FTO on more than two months old pending claims with a copy to the concerned chief commissioner to enable the office to monitor this issue on a regular basis.

Meanwhile, in a letter to the FTO, Pakistan Apparel Forum has assured it to follow the instructions for filing a report on a monthly basis with the registrar of the office regarding more than two months old pending sales tax cases. – *Courtesy Business Recorder*

FBR to impose penalty on false national tax, CNIC numbers

The Federal Board of Revenue (FBR) has decided to impose a Rs 5,000 penalty on registered persons in case of providing fake national tax number (NTN) and computerised national identity card (CNIC) number of unregistered persons in sales tax return.

Sources told on Wednesday that under SRO 821(I)/2011, it was necessary for the registered firms to provide NTN/CNIC number of unregistered persons, in case of sales to them, from January 2012.

However, FBR, accepting the demand of the business community, relaxed the condition of providing NTN/CNIC number of the unregistered buyers/sellers in the monthly sales tax return submitted by the registered persons.

The relaxation has been granted for two months, and now the registered manufacturers, importers and exporters can submit their sales return of January and February 2012 without any CNIC number or NTN of unregistered persons.

However, sources said, FBR has decided to implement the condition of NTN/CNIC number in a phased manner, starting from

April 2012, in which March sales tax return will be submitted, registered manufacturers, exporters and importers will be required to show a minimum 60 percent of the sales to identifiable persons, which NTN/CNIC number should be provided in the sales tax return.

Monthly, 10 percent will be increased in the total sales for NTN/CNIC number condition and, finally in August 2012, in which July 2012 sales tax return will be submitted, 100 percent of the sales is to be shown to the identifiable persons whose NTN/CNIC number will be provided in the sales tax returns.

Overall, FBR has relaxed the condition of CNIC number/NTN for six months and after that it will be implemented in full manner.

The board has also decided to impose fine on those registered manufacturers, importers and exporters, who will submit fake/false NTN/CNIC number to fulfil the FBR formality.

Sources said that FBR will verify the NTN/CNIC number data from its own and Nadra data base to confirm that the given details are true or false.

"FBR has proposed a penalty of Rs 5,000 for each wrong CNIC number/NTN submitted by registered person, which will also include in the arrears appearing in the sales tax return.

The notification to implement this would be issued soon.

It may be mentioned here that the side condition was to implement from January this year, however on the request of manufacturers, importers and exporters the FBR has extended its implemented.

Since the issuance of SRO 821(I)/2011 on September 06, 2011, registered manufacturers, importers and exporters were striving hard for relaxing the condition of mentioning NTN/CNIC number in the sales tax return submitted by registered persons. – *Courtesy Business Recorder*

SRB refuses to rescind 19 percent ST on security systems/services: phmea

Sindh Revenue Board (SRB) has rejected Pakistan Hosiery Manufacturers and Exporters Association's (PHMEA) demand to rescind the 19.5 percent sales tax on security systems and services.

Well-informed sources in SRB told on Wednesday that PHMEA had appealed to the SRB urging it to rescind the 19.5 percent sales tax on security systems and services.

A letter written by PHMEA a few days ago to Sindh Finance Minister, a copy of which is available with, states: "We are constrained to invite your kind attention to the most unjustified imposition of 19.5 percent Sales Tax by the Sindh Revenue Board on security systems and services installed/maintained by the heavily burdened and harassed industrial units.

It is indeed a great irony that these industrial units, majority of which are 100 percent export oriented, are generating massive employment and earning huge amount of foreign exchange for the nation, face the most serious law and order situation, a total lack of security and helplessness just because the government, which is required to assure every kind of safety and security, is lacking in providing this most important right of a citizen.

While punishment has been imposed by the government in the form of most exorbitant and unjustified 19.5 percent Sales Tax charged on the security systems and services providers who in turn charge the same from the industrial units which arrange security through them."

The PHMEA says in the letter that it is pertinent to note here that the Security Services and Systems have mushroomed in our country only because of a feeling of total lack of security.

In the context of the law of demand and supply, they have multiplied just because there is a great demand for them due to the deteriorating law and order situation.

If the government ensures foolproof security then there will be no need of Security Services and Systems.

"We, therefore, most fervently appeal to your good self that in view of the above and the most grave and rapidly deteriorating law and order situation when we are forced to arrange the security services and systems which greatly adds to the already rising cost of doing business in Pakistan, to kindly rescind this unjustified 19.5 percent Sales Tax on Security Systems and Services forthwith and give some breathing space to the dying industries," the letter demanded.

However, the SRB has refused to entertain the PHMEA demand.

In a letter, it states: "Services provided or rendered by a Security Agency (eg, security guards or security escort) are covered by tariff heading 9818 1000 of the First Schedule of the Sindh Sales Tax on Services Act 2011, and are not taxable, having been not included in the Second Schedule thereof.

The telecommunication-based vehicle tracking service (tariff heading 9812.9490) and the burglar alarm service (tariff heading 9812 9500) are taxable services in terms of section 3 of the Sindh Sales Tax on Services Act 2011, read with the Second Schedule thereof."

However, the tax on these telecom-based services were levied at 19.

5 percent even under the Federal Excise Act 2005, and continue to be levied in areas other than Sindh.

Therefore, this is neither a new levy under the Sindh Sales Tax on Services Act 2011, nor is there any discrimination as against the levy (in the form of FED) in areas where the said 2011-Act does not apply," the letter added.

The Sindh Sales Tax on the telecom-based services (tariff heading 9812.9490 and 9812.9500) can be claimed for input tax adjustment/credit under section 7(1), read with section 2(14) (d) of the sales tax Act 1990.

Accordingly, there is no additional burden on the registered persons (whether dealing with taxable goods and/or zero-rated goods) who pay the Sindh Sales Tax on these services used as their inputs," the letter concluded. – *Courtesy Business Recorder*

SECP for freezing CGT rates till June 2014

Chairman SECP Muhammad Ali has said that under Capital Gains Tax regime, the SECP has locked horns with the FBR to freeze CGT rate at the existing level until June 2014, as to give ample time to investors for entering the capital market who had left it after 2008 crisis and invested in other sources including real estate.

This, he said, while addressing a press conference. He further said "It will take a while to bring those investors to the stock market again so we are asking for June 2014, as if the time period is short then market volatility will be high and people will come invest, earn and then withdraw their investment. We want the proper documentation of income through this mechanism."

He has rejected the impression that the continuation of section 111 of Income Tax Ordinance 2001 will help investors to white their illegal money and added that there were already many cheaper ways to white illegal money than why investors will choose risky way to white illegal money

The Chairman SECP further said that SECP also proposed the Capital Gains Tax on securities for a period up to six months at 8 per cent whereas at 10 per cent above six month to one year for any person for any amount inserted in the stock markets in Pakistan from April 1st this year to June 30, 2014. He said, in Pakistan since 1974 till June 30, 2010 (36-yer) securities trading remained exempted from CGT and the wealth which was created during this period is legal, but not documented because neither investors filed returns nor FBR ever asked them. Now we want to document it. Due to the CGT, 'turn over' in stocks have started increasing.

To a question that what will be the minimum holding period, Ali replied that we are at the initial stage but there could two models. Either the investment should remain for a certain number of days, but it is not practical reason is investors in stock market always constantly trade or take the 'weighted average' of the number of days the investment remained in the market it can be three months or six months, "we are not sure at this stage we are discussing and will study it with FBR." – *Courtesy The Nation*

FTO directs FBR to submit monthly progress report

The Federal Tax Ombudsman (FTO) has directed the Federal Board of Revenue (FBR) to file monthly progress report about disposal of rebate or duty drawback claims.

In similar complaints filed by five different taxpayers, the FTO observed that despite repeated directives for processing and payment of rebate and duty drawback claims without delay, a large number of claims keep piling up without any reason, which is tantamount to maladministration.

The FTO recommended that the revenue body should direct collector customs to ensure timely processing and payment of all pending rebate and duty drawback claims and submit a consolidated monthly report about pendency and disposal of rebate and duty drawback claims on the format already circulated to all the collectors across Pakistan.

The FBR is also directed to take adequate steps to liquidate pendency of duty drawback claims on sustainable basis and report compliance within 30 days. The directives were issued on February 7 in the case where complainants had sought indulgence of the FTO against withholding of their duty drawback claims.

The taxpayers prayed that a few cheques were issued by the FBR, but the same had been dishonoured. According to them, the duty drawback claims were withheld without any justification.

The respondent on behalf of the revenue body explained that due to transfer of deputy collection who issued the cheques the banks returned the cheques as signatures differed.It was assured that as soon as the dishonoured cheques were retuned, fresh cheques would be issued on the same day.

It was submitted by the respondent that it had been agreed between the department and the chamber of commerce that each month around 5,000 duty drawback claims in the queue would be sanctioned. Due to transfer of two deputy collectors some delay occurred in sanctioning of duty drawback claims and the pendency rose to around 14,000, the FTO was informed. However, in last 15 days, around 3,000 claims were sanctioned and all efforts were being made to clear the backlog at the earliest.

The respondent assured that all pending duty drawback claims of the complainants would be processed on their turn. – *Courtesy The Nation*

Proposed CGT regime: FBR critical of section 111 exemption, NCCPL role

The Federal Board of Revenue will convey its strong reservations over the proposed regime of capital gains tax (CGT) to the Ministry of Finance on two key issues - exemption from section 111 (unexplained income or assets) of the Income Tax Ordinance 2001 to investment made in stock market upto June 30, 2014 and declaring National Clearing Company of Pakistan (NCCPL) as a withholding agent to deduct and deposit the CGT from investors.

Sources told here on Thursday that the FBR will submit a detailed note to the Ministry of Finance on its viewpoint on the most important issues of the proposed regime of the CGT.

The legal, technical and financial implications of the proposed CGT regime would be clarified to the Ministry of Finance.

In this connection, the FBR is convening regular meetings with the high-ups of the Finance Ministry.

Firstly, it has been reported that the exemption from section 111 of the Income Tax Ordinance 2001 would be available up to June 30, 2014.

After this period, source of investment would be probed by the tax department under the new CGT scheme.

On this proposal, the FBR has opposed the idea of granting exemption from section 111 of the Income Tax Ordinance 2001 up to June 30, 2014.

The FBR is not in favour of giving any exemption from disclosing source of investment made in future by the investors of the stock exchanges.

Even exemption from disclosing source of investment made in the past should only be available to those having genuine investments in stock market.

The FBR has opposed any blanket exemption to the investors of stock market from the provisions of section 111 of the Income Tax Ordinance 2001.

Secondly, the FBR will have to first study the systems of the (NCCPL) before declaring it as withholding agent.

In this connection, a senior official of Inland Revenue Service will visit Karachi on Monday (February 13) to study the system of the NCCPL.

So far, the FBR opposed the proposal of declaring (NCCPL) as a withholding agent to deduct and deposit the CGT from investors of stock exchanges.

The FBR is not ready to give any kind of assessment powers to the NCCPL.

If the government wanted to declare the NCCPL as withholding agent, the FBR is also not in favour of giving any assessment powers to the NCCPL.

The right of assessment should remain with the Inland Revenue Service officers under the Income Tax Ordinance 2001 and such assessment powers cannot be given to any withholding agent of the CGT.

However, the FBR has to first analyse the systems of the NCCPL before giving its final proposal on declaring it as withholding agent.

Under the proposed CGT regime, it has been proposed that NCCPL shall act as a withholding agent to deduct and deposit the CGT from investors' transactions.

The NCCPL shall also provide investor-wise monthly report of CGT deducted and deposited for each investor to FBR and issue a certificate to the investor of the amount deducted.

The investor will file tax return, including the CGT deposited, based on the certificate provided by NCCPL. – *Courtesy Business Recorder*

Fiscal Year 2011 ST refund claims: FBR issues final notices to textile sector

The Federal Board of Revenue has issued final notices to the textile sector for submission of sales tax refund record for audit of last fiscal year.

Sources told on Thursday that almost all zero-rating sectors including textile have received reminders and notices from different audit units of Regional Tax Office (RTO) Karachi for post audit of the sales tax refund.

The tax department has selected several cases for comprehensive post sanction refund audit under Rules 26 A (8) of the Sales Tax Rules 2006 to ascertain the genuineness of the refund claimed/sanctioned, according to notices issued to textile units.

Initial notices to these units were issued, during December 2011, by the RTO Karachi under section 25 of the Sales Tax Act 1990, asking the textile units to submit sales tax record of the refund claims sanctioned during 2010-11, however a large number of units/exporters have not submitted the relevant documents required during the timeframe given by the tax department.

Sources said after sending one reminder in January 2011, now the RTO has issued final reminder/notice to the textile units, which availed the zero-rating facility on utility bills (gas and electricity), for granting a last chance to submit sales tax refund record with tax office.

For the audit, the RTO is seeking sales tax returns, sales/purchase invoices, sales/purchase registers, bill of entry/shipping bills/goods declaration, bill of lading, item-wise stock consumption statement, item-wise production statement, utility bills, proof of payment and receipts as envisaged in section 73 of the Sales Tax Act 1990 along with bank statement and part ledgers, list of machinery along with production capacity and proof of delivery and receipt of goods to and from manufacturing premises.

Although, all the notices have been issued by different audit units of RTO, the details required by the department are different in the notices while in some notices the tax dept also sought employees' record, bank statement along with proof of payments, income tax return and annual accounts, declaration of business bank account, monthly tax return, monthly production report and purchase orders record.

However, textile sector claimed that among these documents most of the record has already been with RTO and there was no need to issue notices.

These notices have created panic among textile exporters and they are planning a joint strategy to handle these notices.

In the final reminders, the tax department has threatened that necessary action under section 21(2) of the Sales Tax Act 1990 will be initiated against units without further correspondent, they added. – *Courtesy Business Recorder*

FTO concerned at piling up of duty drawback claims

Federal Tax Ombudsman (FTO) Dr Muhammad Shoaib Suddle has expressed concern over huge blockage of rebate/duty drawback claims of exporters by the customs authorities despite repeated directions of the FTO on clearance of pending claims.

In a latest order, FTO has given its findings in the case of pilling up of rebate/duty drawback claims of exporters, reflecting total failure of customs department in clearance of pending duty drawback claims.

According to findings of the FTO, despite the FTO's repeated directions for processing and payment of rebate/duty drawback claims without delay, a large number of claims piled up without any justification, which tantamount to maladministration as defined under Section 2(3) of FTO Ordinance.

To resolve the issue on a sustainable basis, the FTO has directed the Customs Department to file monthly progress report about pendency/disposal of rebate/ duty drawback claims.

The FTO has recommended the FBR to direct Collector Customs to ensure timely processing and payment of all pending rebate/duty drawback claims.

The FBR should also submit a consolidated monthly report about pendency and disposal of rebate/duty drawback claims on the format already circulated to all the collectorates across Pakistan.

The FBR should also take adequate steps to liquidate pendency of duty drawback claims on a sustainable basis and submit compliance report within 30 days.

Details of the case revealed that five complainants have sought indulgence of the FTO against withholding of their duty drawback claims.

They have filed lists of their duty drawback claims and prayed that the Department be advised to pay the due amount due immediately and not delay payments in future.

In response to the notices of complaints issued to the Secretary, Revenue Division, Islamabad, the Department has filed para-wise comments pleading that duty draw-back claims are being paid regularly after thorough scrutiny, verification of documents and observing other legal formalities on first come first serve basis.

According to the report submitted by the Department about status of duty drawback claims, which is on the top of the queue were sanctioned and rest of the claims being in queue would be sanctioned on their turn.

The complainants were supplied copies of para-wise comments but they did not opt to file a rejoinder.

Parties were given opportunities of hearing.

The authorised representative (AR) at the very outset submitted that a few cheques were issued by the Department but the same had been dishonoured.

According to the AR, the duty drawback claims had been withheld without any justification.

The departmental representative (DR) explained that due to transfer of Deputy Collector who issued the cheques the bank returned the cheques as the signatures differed.

The DR assured that as soon as the dishonoured cheques were returned, fresh cheques would be issued on the same day.

The DR further submitted that it had been agreed between the Department and the Chamber of Commerce that each month about 5,000 duty drawback claims in the queue would be sanctioned.

The DR submitted that due to transfer of two Deputy Collectors some delay took place in sanctioning of duty draw-back claims, and the pendency rose to about 14,000.

However, in last 15 days about 3,000 claims had been sanctioned and all efforts were being made to clear the backlog at the earliest.

The DR assured that all pending duty drawback claims of the complainants would be processed on their turn.

Despite the FTO's repeated directions for processing and payment of rebate/duty drawback claims without delay, a large number of claims kept piling up without any justification.

The FTO has directed the department to file monthly progress report about pendency/disposal of rebate/duty drawback claims. – *Courtesy Business Recorder*

Banks agree on $25 billion deal for US homeowners

President Barack Obama and top US mortgage lenders unveiled a landmark $25 billion deal on Thursday to help struggling homeowners get back on their feet and to untether the moribund housing market.

Five of the country's top banks, the federal government and 49 states — all except Oklahoma — agreed to help homeowners cut their mortgage debt, avoid default or get compensation for unfair home repossessions.

President Barack Obama said the pact would "turn the page on an era of recklessness that has left so much damage in its wake."

The agreement provides a glimmer of hope for the four million families who lost their homes during the financial crisis and the millions more who watched the market value of their homes slump while the cost of their mortgages remained at boom-era prices.

It also offers an estimated $2,000 in compensation for some of those who lost their homes amid questions about banks losing paperwork and signing documents without due process — so-called robo-signing. While the three-year deal will not come close to cleaning up all the damage caused by the crisis, there is expectation it will be a boon for the market and the broader economy.

The housing bubble was at the center of the 2008 financial crash, the worst in 80 years.

In the boom years, many Americans borrowed beyond their means to buy homes as Wall Street overdosed on exotic mortgage-based derivatives, further inflating the market.

The deal announced Thursday will see at least $17 billion spent by the banks on principal reduction for borrowers who are delinquent or at imminent risk of default, $3 billion for borrowers who are underwater on their mortgages, and $1.5 billion for those whose homes were foreclosed from 2008 to 2011.

Around $4.3 billion will be distributed to states.

The details — particularly how much is used to write-off mortgage principal — will determine just how much the deal helps the economy, according to Ted Gayer, co-director of economic studies at The Brookings Institution.

"A lot of the other stuff has already been done with marginal effects," he said.

"Lets say we get $10-20 billion of principal reduction... $10-20 billion doesn't seem huge when you are talking about $700 billion in underwater equity, so I would not expect huge effects."

"The only caveat is there could be an effect from some sort of resolution of uncertainty for the banks."

For Bank of America, JPMorgan Chase, Wells Fargo, Citibank and Ally Financial, the deal begins to close the curtain on a fraught period marked by multiple law suits and government probes.

Supporters hope the deal will make banks more willing to resume lending and, if successful, will show banks the benefits of future voluntary writedowns.

"A final agreement can play an important role stabilizing and providing certainty and confidence to the housing and mortgage markets," said David Stevens, head of the Mortgage Bankers Association.

But US Attorney General Eric Holder was quick to stress the deal does not give criminal immunity to lenders, or to traders who improperly sold mortgage-backed securities.

"It does not prevent state and federal authorities from pursuing criminal enforcement actions," he said, adding that a new task force was looking into how Wall Street securitized mortgages.

The deal notably does not include Fannie Mae and Freddie Mac, which hold the bulk of home loans in the United States.

California Attorney General Kamala Harris said she for one would try to forge a deal with the two government-backed lenders.

"I will continue to fight for principal reductions for the approximately 60 percent of California homeowners whose loans are owned by Fannie Mae and Freddie Mac," she said.

Bank shares were mixed amid the news.

Bank of America's shares crept up 0.6 percent, but JPMorgan Chase fell 1.2 percent, Citigroup lost 1.7 percent, and Wells Fargo gave up 0.2 percent.

Oklahoma, the sole holdout, said it had reached a "independent" deal worth $18.6 million.

"We had concerns that what started as an effort to correct specific practices harmful to consumers, morphed into an attempt by President Obama to establish an overarching regulatory scheme," the state's Republican Attorney General Scott Pruitt said in a statement. – *Courtesy The News*

Audit of banks for monitoring WHT: RTOs given concurrent jurisdiction

The Federal Board of Revenue has given concurrent jurisdiction to the Regional tax Offices (RTOs) for initiating audit of banks for monitoring of withholding tax covering salary, profit of debt, interest payments, cash withdrawals, payments of rents, purchases/supplies, etc, under the relevant provisions of the Income Tax Ordinance, 2001.

When contacted, a tax expert told on Friday that the exercise of jurisdictions by 12 RTOs simultaneously by banks would create problems for the banks to fulfil their requirements to the satisfaction of all RTOs.

The exercise of monitoring of withholding tax has already been carried out by the respective RTOs where the banks are being assessed.

Thus, the FBR exercise of monitoring/audit exercise is going to create problems for banking companies who are already contributing as major taxpayers in both direct and indirect taxes, experts added.

The FBR order of Inland Revenue Services of January 23, 2012 says, the FBR has directed that the Commissioners of Inland Revenue to concurrently exercise the powers and functioning for

withholding audit of taxes withheld by the concerned branches of all banks.

The Commissioner Inland Revenue (Zone-I) of Regional Tax Offices (RTOs) Rawalpindi, Faisalabad, Multan, Bahawalpur, Sargodha, Sialkot, Gujranwala, Abbottabad, Peshawar, Sukkur, Hyderabad and Quetta shall have the powers for concurrent monitoring of withholding taxes and to perform withholding audit of taxes withheld by the concerned branches of all banks in addition to exercise of powers and functions as already assigned, exercise powers and perform functions as assigned.

All bank branches falling under the jurisdiction of concerned Regional Tax Office, office order added.

Meanwhile, Large Taxpayer Unit (LTU) Karachi has sought details of the perks and privileges given to the senior bank officials including memberships of clubs/loans from certain banks for carrying out withholding tax audit of banks under section 149 of the Income Tax Ordinance 2001 for period from January 1, 2011 to December 31, 2011.

Sources stated that the LTU Karachi has issued intimations to some banks for conducting audit of withholding tax under section 149 of the Income Tax Ordinance 2001.

According to one of the intimations issued to a bank by the LTU Karachi, in order to monitor the tax deduction u/s 149 of the Income Tax Ordinance, 2001 and its deposition into the government treasury within stipulated period, the team of audit officials of the LTU Karachi would visit the Head office of the bank to conduct audit of the aforementioned withholding tax.

The bank should inform the concerned officials and ensure presence of the following documents for examination by the visiting audit team: Firstly, list of all permanent employees of the bank of all grades along with break-up of salary, perquisites paid for the aforementioned period.

Secondly, list of all contractual employees of the bank given contract in any grade along with break-up of salary, perquisites paid for the aforementioned period.

Thirdly, bank officials should also show salary statement e-filed by the bank for the subject period along with supporting challans.

Fourthly, files pertaining to the salary agreement entered into with all the employees (permanent and contractual) of the bank

should be readily available for examination as identified by the head of the audit team.

Fifthly, if any employee has been made any payment under the head of "services rendered" the contract for such payment should also be arranged for the audit team.

Sixthly, as all perks given by the bank to its employees are part of the taxable salary, the list of employees to whom house loans, car loans and personal loans have been granted by the bank, should be ready for examination as the same also fall within the purview of perquisites, being part of taxable salary.

Seventhly, list of employees to whom club memberships have been provided by the bank along with details of club membership fee, subscription/ bill paid for the period under consideration.

Eight details/break-up of medical allowances provided to all the employees for the period under review.

Nine, details/break-up of Insurance premium paid on behalf of the employees by the bank for the period under review.

LTU Karachi further said that it has been noted that higher officials of the bank are provided several vehicles along with unlimited fuel, lists disclosing all such vehicles along with the quantity of allowed fuel along with the name of officer of the bank to whom the vehicles have been allotted be also made available for examination by the audit team.

As most of the higher officials of the bank are provided fully furnished rented premises along with several security guards, the lists of the same along with details of rent paid by the bank for the property and the cost incurred on the security guards may also be prepared and made available to the audit team, LTU Karachi added. – *Courtesy Business Recorder*

NLC income: FBR to approach defence ministry

The Federal Board of Revenue has decided to approach the Ministry of Defence to finalise the issue of taxing the income of the National Logistic Cell (NLC), as the tax authorities have already cancelled the income tax exemption certificate granted to the NLC under section 49 of the Income Tax Ordinance, 2001.

Sources told on Friday that the taxation of NLC income is a subject of dispute between FBR and NLC.

Both the Law and Justice Division and Cabinet Division have informed the FBR that NLC is not part of the federal government having its own organisational set-up.

Legally, such organisations are not exempted from taxes under section 49 of the Income Tax Ordinance 2001.

Details of the issue revealed that the NLC claim exemption from payment of income tax on the basis that they are part of the government of Pakistan and hence income is exempt under section 49 of the Income Tax Ordinance, 2001.

The section 49(1) of the Ordinance, 2001 grants exemption to the income of the Federal Government.

However, sub-section (4) ibid provides that exemption under this section shall not be available to a corporation, a company, a regulatory authority, a development authority, other body and Institution established by or under Federal Law or other body or institution set-up, or controlled either directly or indirectly by the Federal Government.

In order to adjudicate the claim of exemption by NLC, it is imperative to decide whether this concern is a part of the Federal Government or is a body set-up and controlled by the Federal Government.

According to the sources, in an attempt to resolve the dispute the matter was referred to the Ministry of Law, Justice & Parliamentary Affairs for their opinion after bringing on record the relevant facts and rival arguments.

The Ministry of Law and Justice vide their O.M No 899/2011-Law-I dated November 21, 2011 has opined that M/s NLC has its own organisational set-up but for administrative purposes only it will be attached to the Planning & Development Division of the Government of Pakistan, which does not make it a part of the Government.

As an abundant precaution it was deemed appropriate to seek opinion of the Cabinet Division for determination of the legal status of NLC.

Cabinet Division vide its U.O.

No 4-9/04-Mm-1, dated January 17, 2012 clarified that NLC, although administratively attached with Planning and Development Division is not a part of the Federal Government having its own organisational set up.

It was also stated that the advice of Law, Justice and Parliamentary Division vide their O.M No 899/2011-Law-I dated November 21, 2011 was clear on the issue, sources maintained.

Accordingly, the exemption certificate issued to NLC was cancelled as its income was taxable.

In the meanwhile, Ministry of Defence is also examining the issue of taxation of the NLC income.

Accordingly, the follow-up action has been held in abeyance by the FBR.

The FBR will make a request to the Ministry of Defence to examine the matter under reference at the earliest and FBR may be advised by the Ministry of Defence on the future course of action, sources added. – *Courtesy Business Recorder*

Duty on confiscated vehicles: Illegal customs guidelines cost exchequer dearly: FTO

"The illegal customs guidelines of the Federal Board of Revenue on the assessment of duties and taxes of the confiscated vehicles issued in violation of Customs Act, 1969 has resulted in huge revenue loss."

These were the findings of Federal Tax Ombudsman (FTO) Dr Muhammad Shoaib Suddle on a complaint alleging maladministration on the part of Customs officials, Peshawar, for inordinate delay in verification of Customs NOC in 2009 for registration of his Toyota Land Cruiser, which consequently resulted in cancellation of the deal to sell the vehicle, causing the complainant a loss of Rs 500,000.

The FTO has also ordered the FBR to immediately recover short-levied amount of duty and taxes where the benefit of the FBR's unlawful Guideline was wrongly granted to vehicles dealer in the past.

Collectors of Customs would recover the amount in cases where benefit of the illegal Customs Guidelines has been given.

The FTO has observed that the arbitrary withholding of verification of NOC already issued to the complainant by the Customs at Peshawar and non-response to the complainant's letters as well as of Motor Registration Authority (MRA) letter constitute maladministration.

The Guideline No (v) contained in FBR letter C.No 10(17)L&P/05 dated March 8, 2006 being patently violative of the explicit provisions of Section 30 of the Customs Act, 1969, its issuance is void ab initio.

Moreover, coercing recovery in any manner other than that provided under the law involves maladministration under the FTO Ordinance, 2000.

The FTO has recommended the FBR to direct the Collector of Customs, Peshawar, to confirm the genuineness of NOC to MRA, Islamabad.

The FBR should direct all Collectors in Pakistan to recover the short levied amount of duties and taxes etc where the benefit of the FBR's unlawful Guideline was unduly granted in the past.

The FBR should submit vehicle-wise and year-wise details of recoveries made, as per law.

The FBR should proceed against those found responsible for issuing the Guidelines which was contrary to law and report compliance within 30 days, FTO added.

The FTO has observed that as regards the Guideline No (v) of FBR letter C.No 10(17)L&P/05, by failing to mention “or date of payment of duty and taxes, whichever is higher,” it is violative of Section 30 of the Customs Act.

The resultant corrective action therefore will need to be taken uniformly in all cases where the benefit of the Guideline was availed.

Those in the FBR who issued the unlawful Guideline also need to be effectively disciplined, FTO directed.

The complaint was referred for comments to the Secretary Revenue Division in terms of Section 10(4) of the FTO Ordinance, 2000.

In response, the Collector of Customs, Peshawar, filed para-wise comments stating that while applying for adjudication, the complainant, vide application addressed to the Additional Collector (Adjudication), indicated his readiness to pay the applicable duty, taxes and redemption fine.

However, when the adjudicating officer allowed the release of the vehicle, the Complainant instead filed appeal against the Order-in-Original (O-in-O) No 672 dated December 20, 2006.

It was only when the appeal failed at the level of both the Collector (Appeals) and the Appellate Tribunal that the complainant applied for the release of the vehicle.

The complainant also furnished an undertaking dated November 17, 2009 to pay any short-levied amount of duty and other taxes.

The Customs Department instead of finalising the demand in accordance with the fourth proviso to Section 30 of the Customs Act, 1969, which required assessment either at rate prevalent on the date of seizure or that on the date of payment of duty and taxes, whichever was higher, erroneously applied the FBR's "Guidelines for the implementation of amendments made in SRO 574(I)/2005 June 6.

2005" and determined the amount of duty, taxes and fine at Rs 1,177,615 on the basis of the date of seizure, which resulted in short levy of duty and taxes amounting to Rs 2,071,890.

The department contended that verification of NOC was to be done only after the Complainant had fulfilled his undertaking and deposited the short-levied amount for which a demand notice was issued. – *Courtesy Business Recorder*

Tax discrepancies to the tune of Rs 1.5 billion detected

Directorate General Intelligence and Investigation (DGI&I) of Federal Board of Revenue (FBR), Karachi has detected tax discrepancies to the tune of Rs 1.5 billion, approximately in the ledgers of 213 registered units.

According to sources, the action was taken on a tip-off, which revealed that these companies were involved in issuance of fake invoices and its output were being used for claiming refund or input tax adjustment by other registered persons.

As per registration record of sales tax department, these companies got sales tax registrations and hold the category of importer/exporter/wholesaler.

However, the department had not found physical existence of these companies after inquiry.

They said the suppliers of the said companies in response to the letters of the department denied to have supplied any goods to them and added that operators of those fake units were also involved in filing monthly sales tax returns of some other fake companies.

Moreover, they said those companies by claiming inadmissible input tax through fake and fraudulent sales tax returns, fake bank account and fake sales tax invoices had deprived the national exchequer to the tune of Rs 1.5 billion, approximately.

They said the DGI&I in its challans submitted in Custom Court had so far nominated some 213 companies and six Inland Revenue officers over the charge of their alleged involvement in this multibillion fake sales tax refund fraud.

They said those units were also asked to give evidences and produce documents pertaining to the sales tax refund claims but they have failed to produce the same hence the names of these units along with the said Inland Revenue officers were included in the challans.

They said those registered units had showed taxable sales and refunded billions of rupees sales tax from national exchequer.

They said the department was going to finalise the inquiry of some 3,500 units in this scam and those units with the connivance of sales tax officers had fabricated this tax fraud.

Furthermore, the sources anticipated the amount involved in this scam would cross the mark of Rs 10 billion and more challans in this regard are going to be finalised, soon. – *Courtesy Business Recorder*

No. SCD/M/SCSAM/2012 Islamabad, the 3rd February, 2012

SECP CIRCULAR NO. 08/2012

Subject: ***Shari'ah* Compliance and *Shari'ah* Audit Mechanism (SCSAM) for Modarabas.**

Section 10 of the Modaraba Companies and Modaraba (Floatation and Control) Ordinance, 1980 (the Modaraba Ordinance) provides that no Modaraba shall be a business which is opposed to the injunctions of Islam and the Registrar shall not permit the floatation of a Modaraba unless the Religious Board has certified in writing that the modaraba is not a business opposed to the injunctions of Islam.

2. The Registrar, on the basis of the business stated in the prospectus, after obtaining from the Religious Board a certificate to the effect mentioned in section 10 and on being satisfied that it is in the public interest so to do, grant a certificate in the prescribed form authorizing the floatation of modaraba on such conditions as he may deem fit. However, no mechanism is in place to ensure and verify that the business affairs of a Modaraba (after floatation) are being managed in accordance with the principles of *Shari'ah*.

3. The Religious Board in its meetings held on December 9, 2010 and June 13, 2011 deliberated upon this situation and directed to introduce a system to ensure and verify that the business transactions of Modarabas are being carried out in accordance with the injunctions of Islam.

4. In compliance with the directions of Religious Board and in consultation with the NBFI & Modaraba Association of Pakistan (the Association) a formal mechanism namely *Shari'ah* Compliance and *Shari'ah* Audit Mechanism (SCSAM) has been prepared and is being implemented to eliminate the risk or possibility of any violation of *Shari'ah* principles by the Modarabas.

5. The SCSAM aimed to achieve the following objectives:

(i) to ensure that the inflows and outflows of resources of Modarabas are free from the following:

a. *Riba* (interest, usury or any other form)

b. *Qimar* (Gambling)

c. *Gharar* (Speculation)

d. Support from Business Prohibited by *Shari'ah* (*e.g. Drugs and Alcohol, Tobacco, Pork Related Items, etc.*)

(ii) to introduce a mechanism which will strengthen the *Shari'ah* compliance by the Modarabas in letter and spirit and ensure

that the systems, procedures and policies adopted by the Modaraba are in line with the *Shari'ah* principles;

(iii) to mitigate the reputational and operational risk and enhance the image and operational framework of Modaraba as Islamic Financial Institution and to ensure that the financial products or services being offered by Modarabas are in accordance with the *Shari'ah*;

(iv) to ensure that the agreements entered into by the Modaraba are *Shari'ah* compliant, all the financing agreements are executed on the formats as approved by the Religious Board and all the related conditions are met;

(v) to prescribe the screening process for the investments in shares and other securities;

(vi) to provide for the process for purifications of dividend income;

(vii) to introduce the mechanism for the management of charity;

(viii) to identify the avenues for the investment of surplus funds;

(ix) to prescribe procedure for appointment of *Shari'ah* Advisor;

(x) to introduce internal *Shari'ah* audit of the business transactions of Modarabas to ensure that the goals and objectives of Islamic Law i.e. *Maqasad Al-Shari'ah* are achieved and the financial products, instruments and transactions employed, are based on *Shari'ah* norms and principles; and

(xi) to prescribe any other ancillary matter that may be required for *Shari'ah* compliance and *Shari'ah* audit.

6. Now, therefore, in order to ensure effective *Shari'ah* compliance and to maintain the trust of the stakeholders on the Islamic Financial System, in terms of the certificate granted for authorization to float a Modaraba read with Section 11 of the Ordinance and rule 3 (2) (e) of Modaraba Companies and Modaraba Rules, 1981, the following *Shari'ah* Compliance and *Shari'ah* Audit Mechanism (SCASM) is hereby issued as an additional condition to the Modaraba Authorization Certificate:

Shari'ah Compliance and *Shari'ah* Audit Mechanism

Part – I - *Shari'ah* Compliance

I. Responsibilities of the modaraba company:– Every modaraba company shall ensure that:

(i) the business of the Modaraba managed by it, is carried out strictly in accordance with the Prospectus approved by the Religious Board and the model Islamic financing agreements and the investment products approved by the Religious Board from time to time are followed;

(ii) major changes in any of the existing product structures, financing agreements, terms and conditions have a prior written approval from the Religious Board;

(iii) all material changes in the existing product structures, agreements, terms and conditions are properly communicated to the concerned stakeholders, clients/customers;

(iv) monitoring and review system of *Shari'ah* compliance is introduced covering all activities and products of the Modarabas;

(v) proper training is provided in the area of *Shari'ah* compliance to the relevant staff, responsible for the monitoring and review; and

(vi) irregularities, if any, recorded and reported by internal *Shari'ah* Auditor are rectified under the guidance of the *Shari'ah* Advisor.

II. Investment in shares and other securities:– The investment by the Modaraba in the shares and securities shall only be made in the companies screened by the *Shari'ah* Advisor of the Association in accordance with screening procedure contained in clause III of this SCSAM and subject to the following conditions:

(i) the purchase and sale of the same scrip on the same day shall not be made; and

(ii) the shares shall not be sold before settlement i.e. their title and possession has been transferred to the Modaraba, in accordance with the settlement schedule of the Stock Exchange.

III. Screening Procedure:– (1) The screening test of the selected Investee Company (IC) for the purpose of investment in its shares or other securities shall be conducted by the *Shari'ah* Advisor of the Association who shall observe the following criteria before placement of the scrip in the list of *Shari'ah* compliant securities:

(i) the business of the IC *is Halal* and in line with the *Shari'ah*;

(ii) debt to asset ratio of the IC is less than 40%. Debt in this case is classified as any interest bearing debts. Zero coupon bonds and preference shares shall be considered as part of the debt;

(iii) the ratio of non-compliant investments to total assets of the IC is less than 33%;

(iv) the ratio of non-compliant income of the IC to total income is less than 5%. The income includes gross income plus any other income earned by the IC;

(v) the ratio of illiquid assets to total assets is at least 25%;

Explanation: Illiquid asset means any asset that *Shari'ah* permits to be traded at value other than the par.

(vi) The market price per share is greater than the net liquid assets per share calculated as: (Total Assets – *Illiquid Assets* – Total Liabilities)/No. of outstanding shares.

Provided that the investment in the Modaraba certificates of a Modaraba, shares of Islamic Banks and Takuful Companies and the units of Islamic mutual funds shall not be subject to screening process.

(2) The screening for each IC shall be performed on half yearly basis. The list of screened listed companies alongwith charity rate of the respective company shall be placed on the website of the Association and a printed copy duly signed by the authorized person of the Association with a confirmation of its placement on the website, shall be sent to the Registrar Modarabas on half yearly basis.

Explanation: Charity Rate means the ratio of non-compliant income of the IC to total income.

(3) The screening of unlisted companies shall be carried out by the *Shari'ah* Advisor of the Association on the requests made by Modarabas on case-to-case basis.

(4) The existing non-compliant investments in terms of clause III shall be divested within the period of one year from the date of this circular.

IV. Dividend Purification Process:– The dividend income shall be purified by deducting the amount equivalent to charity rate for the respective IC from the total dividend income received by a Modaraba.

V. Non-*Shari'ah* Compliant income not to form part of Modaraba's income:– (1) The income received by a Modaraba from non-*Shari'ah* compliant sources shall not be accounted for as part of income of a Modaraba, inter-alia the following:

(i) late payment penalty or surcharge received from any client;

(ii) the part of dividend income pertains to non-*Shari'ah* compliant business activities of IC as calculated in terms of clause IV; and

(iii) any other income received by a Modaraba from any transaction which was not carried out in accordance with the principles of *Shari'ah*.

(2) All non-*Shari'ah* compliant income received by a Modaraba shall be deemed as a liability of the Modaraba and shall be transferred by the Modaraba Company to a separate account namely Charity Account.

VI. Management of Charity:– The amount credited in the charity account shall be used in the manner and subject to the conditions stated hereunder:

(i) all contributions or donation from the charity account shall only be made to the approved charitable organizations registered under Pakistani law as charitable organization (trusts, Hospitals etc). The Income tax exemption certificate issued by the Government of Pakistan to that effect shall be considered as an approval for the purposes. Any exception shall be submitted for approval to the *Shari'ah* Advisor of the Association;

(ii) the purpose of the donation shall be identified; and

(iii) the amount available in charity account shall ideally be distributed within three months of its transfer. A summary of operations of the charity account shall be published in the Annual Accounts of the Modaraba.

VII. Investment of surplus funds of Modaraba:– The surplus funds of the Modaraba shall only be placed in the accounts to be opened in the Islamic banks or Islamic branches of conventional banks or Islamic Mutual Funds or products offered by a Modaraba or any other *Shari'ah* compliant investment schemes.

Part – II – *Shari'ah* Advisor

VIII. *Shari'ah* Advisor: (1) Every Modaraba company shall have a *Shari'ah* Advisor of the Modaraba appointed on the terms and conditions as it may deem fit, having the qualification and experience and to perform the functions as specified hereunder. The term of office of the *Shari'ah* Advisor shall be three years, which shall be renewable by the Modaraba Company. The first *Shari'ah* Advisor shall be appointed on or before March 31, 2012. The Modaraba Company shall intimate

to the Registrar Modaraba about the appointment of *Shari'ah* Advisor and submit his particulars supported with his relevant documents within 7 days from the date of his appointment.

(2) The casual vacancy caused by the resignation or termination of the *Shari'ah* Advisor shall be filled by the Modaraba Company within 30 days of the resignation or termination as the case may be and the intimation thereof shall be made to the Registrar Modaraba in the manner prescribed above.

IX. Qualification of *Shari'ah* Advisor.– (1) No person shall be appointed as *Shari'ah* Advisor unless he is deemed to be a person of acceptable reputation, character and integrity and has:

a. **Educational Qualification:**

   Shahadat ul Aalmia Degree (Dars e Nizami) from any recognized Board of Madaris with minimum 70% marks and Bachelor's Degree with a minimum of 2nd Class and sufficient understanding of banking and finance.

   OR

   Post Graduate Degree in Islamic Jurisprudence/Usooluddin, L.L.M. (*Shari'ah*), etc. with a minimum GPA of 3.0 or equivalent from any recognized University with exposure to banking and finance.

b. **Experience and Exposure:**

   Must have at least 4 years experience of giving *Shari'ah* rulings including the period of Takhasus fil Ifta; or at least 5 years post qualification experience in teaching or Research and Development in Islamic Banking and Finance.

c. good knowledge to understand English and make out the required reports;

d. exposure in the areas of business or finance specially Islamic Finance;

e. has not been terminated from any organization in any capacity; and

f. does not hold any executive or non-executive position in any Modaraba or Modaraba company except as *Shari'ah* Advisor.

(2) The Registrar Modaraba may relax the requirement of educational qualification and experience in exceptional cases where the person is otherwise qualified for giving *Shari'ah* rulings on banking and financial matters.

X. Functions and responsibilities of the *Shari'ah* Advisor:– (1) The *Shari'ah* Advisor shall generally perform the following duties and functions in the Modaraba:

i. to introduce a mechanism which will strengthen the *Shari'ah* compliance by the Modaraba, in letter and spirit and ensure that the systems, procedures and policies adopted by the Modaraba are in line with the *Shari'ah* principles;

ii. to advise the Modaraba company so as to ensure that the inflows and outflows of resources of Modaraba are free from the following:

   a. *Riba* (interest, usury or any other form)

   b. *Qimar* (Gambling)

   c. *Gharar* (Speculation)

   d. Support from Business Prohibited by *Shari'ah* (*e.g. Drugs and Alcohol, Tobacco, Pork Related Items, etc*.)

iii. to review on regular basis that the business conducted, the transactions carried out and the investments made by the Modaraba are in accordance with the Prospectus of the Modaraba, Islamic Financial Accounting Standards notified by the Securities and Exchange Commission of Pakistan, the principles of *Shari'ah* and goals and objectives of Islamic Law i.e. *Maqasad Al-Shari'ah* are achieved i.e. the financial products, services, related policies and the instruments are based on *Shari'ah* norms and principles;

iv. to vet the new products and services before its submission to the Registrar for its final approval from the Religious Board;

v. to make recommendations to the Modaraba company for potential improvements and the formulation of polices in line with the *Shari'ah* principles and to advise about the process of rectification of irregularities pointed out by him;

vi. to advise on any matter referred to him by the chief executive or the board of directors of the Modaraba Company;

vii. to conduct and arrange *Shari'ah* training programs for the board of directors/officers and the staff of the Modaraba; and

viii. to determine the non-*Shari'ah* compliant income and ensure its transfer to the charity account.

(2) The *Shari'ah* Advisor shall prepare a report on the Modaraba's affairs, to be called as "the Annual *Shari'ah* Advisor's Report" which shall cover the overall *Shari'ah* compliance position of the Modaraba for the whole year and be prepared on the format attached as Annexure-A. The same shall be annexed by the Modaraba Company just after the statutory auditor's report of the annual audited accounts of the Modaraba, to be disseminated to the certificate holders.

(3) Notwithstanding the above, the first report of the *Shari'ah* Advisor shall be prepared and annexed with the half yearly accounts ending on December 31, 2012 and thereafter on annual basis starting from the annual accounts of the Modaraba ending on June 30, 2013.

XI. Powers of *Shari'ah* Advisor (1) Every *Shari'ah* Advisor shall have a right of access at all times to the books, papers, accounts, vouchers, record, information, agreements and reports of the Modaraba, whether kept at the registered office of the Modaraba company or elsewhere and shall be entitled to require from the directors and other officers of the Modaraba company, such information and explanation as he may require for the performance of his duties and the board of directors and all the employees of the Modaraba Company as well as the Modaraba shall be bound to provide the requisite access to the record and information to the *Shari'ah* Advisor.

(2) The *Shari'ah* Advisor shall have direct and regular communications with all levels of management.

(3) The fatwa and ruling of the *Shari'ah* Advisor in all business transactions, not being inconsistent with the ruling of the Religious Board, shall be binding on the Modaraba companies.

XII. Reporting of *Shari'ah* Advisor:– (1) The *Shari'ah* Advisor shall report to the Board of Directors of the Modaraba.

XIII. Dispute Resolution:– In case of any dispute or difference of opinion arises between Modaraba Company and the internal *Shari'ah* auditor on the matters relating to *Shari'ah* interpretation, the same shall be referred to the *Shari'ah* Advisor for the decision. In case of difference of opinion between the *Shari'ah* Advisor of the Modaraba and the Registrar Modaraba on any matter came to his knowledge, the mater shall be referred by the Registrar Modaraba to the Religious Board, whose decision shall be final.

XIV. Performance review of the *Shari'ah* Advisor:– (1) The performance of *Shari'ah* Advisor shall be reviewed by the Registrar Modaraba from time-to-time.

(2) The Registrar Modaraba, after being satisfied that the *Shari'ah* Advisor is not performing his duties as required under this mechanism may direct the Modaraba Company to terminate the services of the *Shari'ah* Advisor before expiry of three years.

Part – III - Internal *Shari'ah* Audit

XV. Internal *Shari'ah* Audit: (1) Every modaraba shall strengthen its existing Internal Audit Department established in terms of regulation No. 1 of Part –IV of the Prudential Regulations for Modarabas, either by appointing a trained internal *Shari'ah* auditor having relevant qualification and experience of the *Shari'ah* audit or train at least one of its existing employees in the internal audit department for the purpose of internal *Shari'ah* audit, on or before March 31, 2012 so that internal *Shari'ah* audit functions becomes fully operational with effect from first day of April 2012.

(2) The training of the internal *Shari'ah* auditor shall be arranged from a well known *Shari'ah* training institute.

XVI. Duties of Internal *Shari'ah* Auditor:– (1) The internal *Shari'ah* auditor shall follow the same reporting norms, as are applicable on the internal auditor under the PRs and the Code of Corporate Governance implemented by the Stock Exchanges.

(2) The minimum required duties of the internal *Shari'ah* auditor shall be to verify on day to basis that the:

(i) business transactions of the Modaraba are *Shari'ah* compliant;

(ii) agreements entered into by the Modaraba are *Shari'ah* compliant and financing agreements executed on the formats as approved by the Religious Board, without any major change, and all the related conditions are met;

(iii) investments of the Modaraba in the shares and other securities are as per list of the companies screened by the *Shari'ah* Advisor of the Association;

(iv) process for purifications of dividend income has been carried out by the modaraba company;

(v) non-*Shari'ah* compliant income has been transferred in Charity Account and distributed in accordance with the manner prescribed in this circular;

(vi) surplus funds have been invested in the avenues prescribed in this circular; and

(vii) to share his findings with the Chief Executive and *Shari'ah* Advisor in respect of all the above items including irregularities, inadequacy in risk management, governance and internal controls which are necessary to avoid non-*Shari'ah* compliant business transactions in the Modaraba.

(3) The Internal *Shari'ah* auditor shall submit his report on quarterly basis to the board of directors with a copy of the Report to the *Shari'ah* Advisor of the Modaraba.

(4) The Internal *Shari'ah* auditor shall maintain a liaison with the *Shari'ah* Advisor and seek his guidance and help in case of any difficulty in ensuring *Shari'ah* compliance of any particular transaction.

XVII. Compliance on the internal *Shari'ah* Auditor's Report:– The board of directors of the Modaraba company, in consultation with the *Shari'ah* Advisor, shall take necessary steps on the observations/recommendation of the internal *Shari'ah* Auditor and prepare an action plan with a timetable for compliance. The audit committee of the Modaraba shall monitor the compliance/implementation of the action plan.

7. Since the *Shari'ah* review system is imperative in ensuring such compliance and an effective *Shari'ah* framework will harmonize the *Shari'ah* interpretations, strengthen the regulatory and supervisory oversight of the Modaraba sector and nurture a pool of competent *Shari'ah* auditors, the implementation of SCSAM will help the management of modaraba companies to achieve the objectives of Halal business as enshrined in the *Shari'ah* and emerge as a responsible member of the Islamic financial regime.

8. The provisions contained in the SCSAM are the minimum requirements for *Shari'ah* compliance to be followed by the modaraba companies and Modarabas in the course of their operations. The Modaraba and the Modaraba Companies may include additional requirements and control in their procedures for the sake of more effective *Shari'ah* compliance and prudence.

9. All the modaraba companies are directed to ensure the implementation of the SCSAM in letter and spirit and initiate necessary action for its compliance with immediate effect.

Annexure- A

Specimen of Annual *Shari'ah* Advisor's Report

I have conducted the *Shari'ah* review of ________________Modaraba managed by _____________ Modaraba Management Company for the financial year ended ________ in accordance with the requirements of the *Shari'ah* Compliance and *Shari'ah* **Audit Mechanism for Modarabas** and report that except the observations as reported hereunder, in my opinion:

i. the Modaraba has introduced a mechanism which has strengthened the *Shari'ah* compliance, in letter and spirit and the systems, procedures and policies adopted by the Modaraba are in line with the *Shari'ah* principles;

ii. following were the major developments that took place during the year:

   a) Research and new product development (Brief on the research and new product development, if applicable)

   b) Training and Development (detail of training conducted by the *Shari'ah* Advisor of the Modaraba management and staff, if any).

iii. the agreement(s) entered into by the Modaraba are *Shari'ah* compliant and the financing agreement(s) have been executed on the formats as approved by the Religious Board and all the related conditions have been met;

iv. to the best of my information and according to the explanations given to me, the business transactions undertaken by the Modaraba and all other matters incidental thereto are in conformity with the *Shari'ah* requirements as well as the requirements of the Prospectus, Islamic Financial Accounting Standards as applicable in Pakistan and the *Shari'ah* Compliance and *Shari'ah* Audit Regulations for Modarabas

v. profit sharing ratios, profits and charging of losses (if any) relating to any deposit raising product conform to the basis and principles of *Shari'ah*.

vi. the earnings that have been realized from the sources or by means prohibited by *Shari'ah* have been credited to charity accounts.

Observation(s)

Recommendation(s)

Conclusion

Signature

Dated: Stamp of the Shari'ah Advisor

S.R.O. 49(I)/2012, Islamabad, the 19th January, 2012.– In exercise of powers conferred by sub-section (2) of section 282B read with section 506A of the Companies Ordinance, 1984, (XLVII of 1984) and having being previously published in the official Gazette vide Notification No. S.R.O.825(I)/2011, dated September 8, 2011 as required by sub-section (1) of section 506A of the said Ordinance XLVII of 1984 the Securities and Exchange Commission of Pakistan hereby makes the following amendments in the Private Equity and Venture Capital Fund Regulations, 2008, namely:–

In the aforesaid Regulations, in Schedule I, in table "A", for the existing row No. 2 and row No. 3 the following shall be substituted,–

"Form II	Application for license to provide PE & VC Fund Management Services	750,000
Form IV	Application for renewal of license to provide PE & VC Fund Management Services"	750,000

S.R.O. 64(I)/2012, Islamabad, the 27th January, 2012.– In exercise of the powers conferred by sub-section (2) of section 53 of the Income Tax Ordinance, 2001 (XLIX of 2001), the Federal Government is pleased to direct that the following further amendment shall be made in the Second Schedule to the said Ordinance, namely:–

In the said Schedule, in Part I, after clause (135), the following new clause (135A) shall be inserted, namely:–

> "(135A) Any income derived by a non-resident from investment in OGDCL exchangeable bonds issued by the Federal Government."

2012 PTR 31 [Trib.]

APPELLATE TRIBUNAL INLAND REVENUE

Munsif Khan Minhas Judicial Member
Abdul Rauf, Accountant Member

EDITOR'S NOTE

The income tax law clearly distinguishes between time limitations pertaining to different legal actions. The Tribunal's judgement confirms this position with respect to limitation for assessment and for giving appeal effect after a case is reverted to the department from the appeal stage.

FACTS/HELD

1. Brief facts are that Taxpayer a Private Limited Company engaged in the business of Oil and Gas Exploration filed income tax return for tax year 2003 declaring net income at Rs.2,177,681/- which was deemed to be assessed u/s 120(1) of the Income Tax Ordinance, 2001.
2. The case was selected for audit andthe Taxpayer Company contested the same first before the CIT(Audit) and then before the honourable Islamabad High Court but of no avail. Due to the non-cooperative attitude of the Taxpayer Company despite provision of number of opportunities, Taxation Officer was left with no alternative but to go for amendment of the assessment under the provision of section 122(1) of the Income Tax Ordinance, 2001
3. Being dissatisfied with the treatment meted out by the Taxation Officer, the assessee preferred appeal before the learned CIR(A) who, after considering the facts and circumstances of the case cancelled the impugned order
4. The learned DR argued that the learned CIR(A) was not justified to cancel the assessment on the ground of being barred

by time, as selection u/s 177 was sub judice before the Lahore High Court and limitation in this case did not apply. The department had legitimate time to amend order u/s 122(1) in the instant case. He further argued that it is settled law that whenever a matter is subjudice before a higher forum the lower authority cannot finalize the issue.

5. He further argued that the taxpayer in response to notice itself suggested to wait for the orders of the Honourable Islamabad High Court. So no one could be allowed to take the benefit of his own fault.
6. Learned AR contended that the amendment of assessment is time barred in terms of section 174(3) because the accounts and documents required to be maintained under this section are for five years after the end of tax year to which those relate. Secondly as per section 122(2), an assessment order could only be amended under subsection (1) within five years after the Commissioner has issued or is treated as having issued the assessment order on the taxpayer.
7. Learned AR argued that the department had drawn attention towards section 226(b) without noticing the fact that the contents of the interim order had not shown any stay from the Honourable Islamabad High Court Islamabad. On the other side the learned Legal Advisor also took section 124(2) as part of his argument.
8. After hearing aurguments of both the sides, the honourable Appellate Tribunal Inland Revenue held that:
   a. section 124(2) is not applicable because it relates to giving effect to the appellate order for which limitation has been prescribed.
   b. Allegation of delaying tactics on the part of the taxpayer is wrong because Taxation Officer himself is supposed to be vigilant about the limitation.
   c. Selection of the case was already hit by time limitation.

Appeal dismissed

ITA No. 708/IB/2010 (Tax Year 2003)

Heard on: 13th August, 2010.

Decided on: 13th August, 2010.

**Present at hearing: Shahid Iqbal, Advocate/L.A., for Appellant.
S.A. Kazmi, ITP, for Respondent.**

ORDER

MUNSIF KHAN MINHAS, Judicial Member.

This appeal has been filed by the department against the order dated 05.05.2010 passed by CIR(A-I) Islamabad for the tax year 2003 on the following grounds:-

a) That the learned CIR(A) was not justified to cancel the assessment on the ground of being barred by time, as the selection u/s 177 was subjudice before the Lahore High Court and limitation in this case did not apply. The department had legitimate time to amend order u/s 122(1) up to 26.11.2009 in the instant case.

b) It is settled law that whenever a matter is subjudice before a higher forum the lower authority can not finalize the issue. Reliance in this regard can be placed on a judgment of the honourable High Court in a case reported as (2002) PTD 1195 (H.C.Lah.)

2. Brief facts leading to this appeal are that Taxpayer a Private Limited Company is engaged in the business of Oil and Gas Exploration. Return for tax year under consideration was filed declaring net income for the year 2003 at Rs.2,177,681/- which was deemed to be assessed u/s 120(1) of the Income Tax Ordinance, 2001. The case of the Taxpayer Company was selected for audit by the CIT(Audit) in terms of provisions of section (b) and (d) of sub-section (4) of Section 177 of the Income Tax Ordinance, 2001. Audit proceedings were accordingly initiated. IDR was issued. The Taxpayer Company contested the selection of the case for audit firstly before the CIT(Audit) and then before the honourable Islamabad High Court but of no avail. Having found the non-cooperative attitude of the Taxpayer Company, despite provision of number of opportunities Taxation Officer was left with no alternative but to go for amendment of the assessment under the provision of section 122(1) of the Income Tax Ordinance, 2001 under the umbrella of mandate given by a binding judgment of the learned ITAT in a case reported as (2008) 97 Tax 262 (Trib). Being dissatisfied with the treatment given by the Taxation Officer, the assessee preferred appeal u/s 127(1) of the Income Tax Ordinance, 2001 before the learned CIR(A) who after considering the facts and circumstances of the case cancelled the impugned order for the year under appeal with the following observation:–

> “Arguments have been heard and the order of the Honourable Islamabad High Court has been perused. Following the ratio decided in the judgment, the order of the Taxation Officer is hereby vacated as the same has been passed beyond limitation.

> The order of the Honourable High Court was very much clear and loud. In view of the foregoing reason the impugned order is hereby cancelled. Since the impugned order has been cancelled on legal issue, hence the other grounds of appeal do not require adjudication."

Being dissatisfied with the treatment accorded by the learned CIR (A), Department has come up in appeal before the Tribunal on the ground raised *supra*.

2*. During arguments learned DR has argued that the learned CIR(A) was not justified to cancel the assessment on the ground of being barred by time, as the selection u/s 177 was subjudice before the Lahore High Court and limitation in this case did not apply. The department had legitimate time to amend order u/s 122(1) up to 26.11.2009 in the instant case. He further argued that it is settled law that whenever a matter is subjudice before a higher forum the lower authority cannot finalize the issue. Reliance in this regard can be placed on a judgment of the honourable High Court in a case reported as (2002) PTD 1195 (H.C.Lah.)

More so the taxpayer in response to notice itself suggested to wait for the orders of the Honourable Islamabad High Court. So no one can be allowed to take the benefit of his own fault. Taxpayer itself played the role to delay the proceedings and he cannot be benefited from the same.

We have heard the arguments and perused the record. In order to show chain of events following tables will help us:–

Selection of case for audit under section 177 of the Income Tax Ordinance, 2001 by Commissioner Audit, LTU, Islamabad.	16.5.2008
Selection was challenged by the taxpayer and Representation filed was finally disposed off by Commissioner (Audit) vide his letter No.498 dated 18.6.2008	18.6.2008
Taxation Officer issued IDR on 9.7.2008 for Compliance by 17.7.2008	17.7.2008
Writ Petition No 960 lodged before Islamabad High Court in August 2008	28.7.2008
Interim decision accorded by Islamabad High Court	18.8.2008

Learned AR contends that the amendment of assessment is time barred in terms of section 174(3) because the accounts and documents required to be maintained under this section shall be maintained for five years after the end of tax year to which they relate. So in view of this section limitation expires on 31-12-2008. Secondly as per section 122(2), an assessment order shall only be amended under subsection (1) within

* This should be No." 3".

five years after the Commissioner has issued or is treated as having issued the assessment order on the taxpayer. So even as per section 122(2) assessment can be amended upto 30-06-2009 while amended assessment order has been passed on 30-09-2009. The department has drawn our attention towards section 226(b) which embodies that in the case of an assessment or other proceeding under this Ordinance, the period, if any, for which such proceedings were stayed by [any Court, [Appellate] Tribunal or any other authority in computing the period of limitation stay time shall stand excluded. In this case writ petition was filed on 28-07-2008, interim order was passed on 18 08-2008 but this interim order does not show any stay rather the contents of the orders are hereby reproduced as follows:

"C.M.1890 of 2008

Hafiz Muhammad Idris, Advocate for petitioner.

> "Taxation Officer Audit III, Large Tax Payer Unit Islamabad may proceed with the matter, Subject to final decision of this writ petition and Subject to notice."

The contents of the order do no* show any stay from the Honourable Islamabad High Court Islamabad. So the department also cannot get any benefit u/s 226(b). The learned Legal Advisor has referred the section 124(2) which is reproduced hereunder:–

> (2) Where, by an order made under Part III of this Chapter by the Commissioner (Appeals), Appellate Tribunal, High Court, or Supreme Court, an assessment order is set aside [2][wholly or partly,] and the Commissioner [or Commissioner (Appeals) as the case may be,] is directed to make a new assessment order, the Commissioner shall make the new order within [5][one year from the end of the financial year in which) the Commissioner (or Commissioner (Appeals), as the case may be,] is served with the order."

This section also cannot come to the rescue of the department because this relates to giving effect to the appellate order for which limitation has been prescribed one year from the end of the financial year in which the Commissioner is served with the order. So this section has to do nothing with the writ petition that too without issuance of any stay. This argument of the learned Legal Advisor that taxpayer himself was using delaying tactics and tried to print image on the mind of the Taxation Officer to wait for the final decision of the writ petition, deprives the taxpayer to contest on the front of limitation, is without any force because Taxation Officer himself is supposed to be vigilant about the limitation. More so on the above titled position shows that selection of this case was made on 16-05-2008 a bit less than five years had already

* Apparently the intended word is "not".

lapsed before the selection of the case. So no edge can be given to the department who has made amended assessment which is beyond the clock. With these observations We are left with no other alternative except to uphold the order passed by the learned CIR(A). Order accordingly.

The departmental appeal hereby stands dismissed.

2012 PTR 36 [Trib.]

APPELLATE TRIBUNAL INLAND REVENUE

M.A. Javed Shaheen, Judicial Member
Tabana Sajjad Naseer, Accountant Member

EDITOR'S NOTE

Revenue authorities remain oblivious to ongoing economic activities until a sudden change of events forces them to nab those found violating the law. Once they manage to catch hold of a taxpayer then they try to squeeze him dry by going beyond their own domain or by unjustly stretching interpretation of statutes.

FACTS/HELD

1. Brief facts are that the Appellant did not get itself registered under the Sales Tax Act, 1990 despite carrying on business as a retailer since Feb., 2001. On being apprised by the Deputy Collector, in December, 2005, that the Appellant was liable to be registered, the Appellant got registered under the Sales Tax Act, 1990 and paid sales tax for tax period 07/2005 to 11/2005 and moved application u/s 65 for exemption of tax not levied by him as general practice.
2. During pendency of the Appellant's Application the Additional Collector issued show cause notice u/s 11(2) & 36(1) of the S.T. Act, 1990, and without waiting for the fate of the Application passed the order in original. The order was assailed before the learned Collector (Appeals), who upheld the treatment meted

out by the Addl. Collector (Adj). The Appellant has assailed the said Order-in-Appeal before this Tribunal.

3. The first and foremost ground taken by the Appellant is the claim of exemption u/s 65 of the S.T. Act, 1990, which as per record is still pending with the F.B.R. despite a lapse of more than five years. The Appellant has argued that he did not levy and pay the sales tax inadvertently as a result of general practice up to 30.06.2005. Secondly, he got his business of "C-MART(s)" registered under the Sales Tax Act, 1990, on being apprised of the fact that he was liable to be registered. Thirdly, he had been paying sales tax from the date when it was found that the supply was chargeable to tax.
4. The Department's rebuttal was that (i) legally, it was obligatory for the applicant to pay leviable sales tax on taxable supplies made by him. Furthermore, it was advertised from time to time by the Government through different notifications that the retailers having annual turnover of more than Rs. 5 million are required to get themselves registered with the Sales Tax Department and to pay sales tax on the sales. (ii) Many other retailers like M/s. Jalal Sons, M/s. Body Shoes and M/s. Raja Sahib etc. were paying leviable sales tax on taxable sales tax on taxable supplies made by them. (iii) Ignorance, of law is no excuse. Furthermore, the issue of sales tax registration has been given vide publicity by the Government.
5. After hearing the parties and perusing the records, the Honorable Tribunal held that:
   a. The provisions granting exemption are to be strictly construed, but it is equally true that a benefit conferred by law subject to certain conditions cannot be withheld if the conditions are complied with/satisfied, and such benefit cannot be disallowed merely on the basis of conjectures and surmises.
   b. The Appellant/Tax-payer is fully entitled to the exemption of sales tax not levied by him up to 30.06.2005 inadvertently and as a result of general practice.

Appeal succeeded

STA No. 1633/LB/2009.

Heard on: 6th May, 2011.

Decided on: 6th May, 2011.

Present at hearing: Syed Ali Imran Rizvi, Advocate for Appellant.

ORDER

M.A. JAVED SHAHEEN, Judicial Member.

This Appeal has been preferred by an individual, who has been running ten convenience stores under the name & style of "C-MART" at Lahore-Islamabad Motorway as a Franchisee of *M/s. Daewoo Motorway Services Pakistan Ltd.*, Lahore since Feb., 2001. This appeal is directed against the Order-in-Appeal No. 177/ST/2006, dated 21.06.2006 passed by the learned Collector of Customs, Sales Tax & Federal Excise (Appeals), Lahore Mr. Muhammad Azhar Iftikhar, which upheld the Order-in-Original No. 08/2006, dated 18.02.2006, passed by the Additional Collector-I, Adjudication, Collectorate of Sales Tax & Federal Excise, Lahore.

2. Brief facts giving rise to this appeal are that this Appellant did not get itself registered under the Sales Tax Act, 1990 despite carrying on business as a retailer on the Lahore-Islamabad Motorway since Feb., 2001. On being apprised by the Deputy Collector, Intelligence, Investigation & Prosecution, S.T. & F.E., Lahore in December, 2005, that the Appellant was liable to be registered, the Appellant moved the Application for registration under the Sales Tax Act, 1990, and his business was registered under the name & style of "C-MART" at Sales Tax Registration No. 03-05-2202-049-19 *w.e.f.* 24.12.2005. As the taxable supplies of this Appellant since 07/2005 suggested that they would cross the exemption limit of Rs. 5 million during the financial year 2005-2006, he paid sales tax for the tax periods 07/2005 to 11/2005 voluntarily alongwith the default surcharge, and he moved application u/s. 65 of the Sales Tax Act, 1990 for exemption of the tax not levied by him as a general practice on 28.12.2005 to the Collector, Sales Tax, Lahore.

3. During pendency of the Appellant's Application u/s. 65, the Additional Collector (Adjudication)-I, Lahore issued Show Cause Notice u/s. 11(2) & 36(1) of the S.T. Act, 1990, and without waiting for the fate of the Application u/s. 65 passed the O-in-O No. 8/2006, dated 18.02.2006 raising the impugned demand of sales tax of Rs. 14,983,892 holding as under:–

> "8. In view of above, I am of the considered opinion that till date, the Collectorate of Sales Tax has not considered the case of the respondent for exemption of sales tax under section 65 of the Sales Tax Act, 1990 and has not sent any such recommendations to the Board. Hence contention of the respondent that he may be allowed exemption under section 65 of the Sales Tax Act, 1990 cannot be accepted at the present stage. The charges against the respondent stand established

beyond any shadow of doubt. I, therefore, determine evaded amount of sales tax amounting to Rs. 14,983,892/- under section 36(3) of the Sales Tax Act, 1990 which is ordered to be recovered from the respondent. Default Surcharge under section 34 of the Sales Tax Act, 1990 is also ordered to be recovered from the respondent. No penalty is imposed keeping in view the spirit of the judgment of the Supreme Court of Pakistan in case titled D.G. Khan Cement Company Ltd., etc. versus the Federation of Pakistan (C.A. 1866/1996) decided on 11-11-2003.".

4. The O-in-O was assailed before the learned Collector (Appeals), who upheld the treatment meted out by the Addl. Collector (Adj), and rejected the Appeal holding as under:–

"9. I have given a serious thought to the version of both the parties. The plea of the appellants is that they had not paid the sales tax inadvertently and has been paying sales tax from the date when it was found that the supply was chargeable to tax. This view as advanced by the appellants is neither legally correct nor it is convincing. The fact is that the appellants have failed to pay sales tax on the taxable supplies from February, 2001 as mentioned in the impugned order in violation of section 3, 3AA, 6, 14, 22, 23 and 26AA of the Sales Tax Act, 1990, deliberately with a view to evade payments of sales tax dues which was otherwise correctly payable. Another contention of the appellants is that even if the appellant is found to be not entitled to the exemption, this case would fall under section 36(2) of the Sales Tax Act, 1990 is also not tenable. The facts of the case clearly prove that the appellant evaded sales tax knowingly and deliberately. Therefore, the appellant's case falls within the ambit of section 36(1) of the Sales Tax Act, 1990. Another contention of the appellant that they were supplying cigarettes and beverages on which sales tax has already been paid is not correct. They are liable to pay sales tax on the value which is being charged by them from customers. The evidence is available on record that many other retailers like M/s. Jalal Sons, M/s. Body Shoes, and M/s. Raja Sahib are paying leviable sales tax on taxable supplies made by them. Since, it all gives a picture of willful non-payment of taxes, I find that the order passed against which appeal has been filed is correct in accordance with law and facts. It is well based.".

5. The Appellant has assailed the said Order-in-Appeal before this Tribunal on the following grounds:–

(1) that the learned Collector (Appeals) has grossly erred in holding that the Appellant/Registered Person's plea that the sales tax was not paid inadvertently, is neither legally correct, nor convincing.

(2) that the learned Collector (Appeals) has grossly erred in maintaining an Order-in-Original arbitrarily made during pendency of the Appellant/Registered Person's Application u/s. 65 of the Sales Tax Act, 1990 dated 28.12.2005 in utter disregard of the hon'ble Customs, Central Excise and Sales Tax Appellate Tribunal's decision in identical circumstances reported in **GST 2005 CL 100**.

(3) that the learned Collector (Appeals) has grossly erred in holding that the Appellant/Registered Person deliberately evaded sales tax amounting to Rs. 14,983,892 in respect of tax period from 02/2001 to 06/2005.

(4) that the learned Collector (Appeals) has grossly erred in holding that the Appellant's case fell within the ambit of Section 36(1) of the Sales Tax Act, 1990.

(5) that even if the Appellant/Registered Person is found to be not entitled to the exemption u/s. 65 of the Sales Tax Act, 1990, his case would fall u/s. 36(2) of the Sales Tax Act, 1990, as there is no finding in the impugned Order-in-Original that the Appellant/Registered Person did not levy and pay the alleged tax 'by reason of some collusion or a deliberate act' envisaged by Section 36(1) of the Sales Tax Act, 1990.

(6) that the learned Collector (Appeals) has failed to adjudicate the issue that the impugned Order-in-Original is time-barred.

(7) that the whole of the sales made by the Appellant/Registered Person did not attract the levy of sales tax.

(8) that the learned Collector (Appeals) has grossly erred in holding that the cigarettes and beverages liable to sales tax u/s. 3(2)(a) r/w. the Third Schedule to the Sales Tax Act, 1990, are chargeable to sales tax in the hands of the Appellant/Registered Person.

(9) that the 'default surcharge' u/s. 34 of the Sales Tax Act, 1990 has been wrongly ordered to be recovered from the Appellant/Registered Person, as the alleged default in levy and payment of sales tax was not willful.

(10) that the learned Collector (Appeals) has grossly erred in treating the Appellant/Registered Person's case at par with the Departmental Stores like Jalal Sons, Body Shoes and Raja Sahib.

(11) that the impugned Order-in-Appeal as well as the Order-in-Original are biased, arbitrary, injudicious and malicious.

(12) that there is no material available on record to justify the impugned Order.

(13) that the impugned Order-in-Appeal is tenable neither on the factual plane, nor on the legal score.

6. The parties were heard in support of their rival pleas, and the record was gone through minutely.

7. The first and foremost ground requiring anxious consideration of this Tribunal is the Appellant's claim of exemption u/s. 65 of the S.T. Act, 1990, which as per record is still pending with the F.B.R. despite a lapse of more than five years, and according to the well-known maxim of law: Justice delayed, Justice denied, amounts to denial.

8. Relying on GST 2005 CL 100, learned A.R. of the Appellant, Mr. S. Ali Imran Rizvi, contended that the Department could not make adjudication of the allegedly evaded tax during pendency of the Appellant's Application u/s. 65. Relevant excerpt out of the cited judgment is reproduced as under:–

> “This conduct of the Adjudicating Officer is against the norms of natural justice, because public functionaries acting in judicial or quasi-judicial capacity are always required to act in a reasonable manner and not to resort to mere hair-splitting with intention to deny a benefit available to an aggrieved person. It is right of the party to avail the opportunity given to him under the law and he cannot be deprived merely on the ground that “no proceedings can be kept pending”.

9. The learned A.R. argued that the Appellant's case does qualify for exemption of the Sales Tax not levied by him upto 30.06.2005 u/s. 65 of the Sales Tax Act, 1990, in as-much-as–

(i) He did not levy and pay the sales tax inadvertently as a result of general practice upto 30.06.2005.

General Practice is evident from the fact that prior to the Appellant, the said convenience stores were run by M/s. Shell (Pakistan) Ltd., which had been operating the filling stations on the Lahore-Islamabad Motorway till 2005. Neither the Appellant/Registered Person nor his predecessor i.e. M/s. Shell (Pakistan) Ltd., was ever apprised by the Sales Tax Department that the sales tax had to be charged on the retail sales of the C-Marts, nor the Appellant/Registered Person or his predecessor, ever charged the sales tax as a retailer.

The concept of having a convenience store on every filling station was introduced by M/s. Shell (Pakistan) Ltd. throughout the country, which was followed by M/s. Pakistan State Oil (P.S.O.); M/s. Caltex Oil (Pakistan) Ltd.; M/s. Attock Refinery; and M/s. PARCO (Total), but none of them has been levying and paying sales tax on the retail sales of its convenience stores till date. It has thus been a general practice not to charge sales tax

on the retail sales being made by the convenience stores. Thus, the Appellant/Registered Person did not levy and pay the sales tax on the retail sales of the convenience stores being run by him inadvertently and as a general practice;

(ii) he got his business of "C-MART(s)" registered under the Sales Tax Act, 1990, on being apprised of the fact that he was liable to be registered; and

(iii) he has been paying the sales tax from the date when it was found that the supply was chargeable to tax.

The learned A.R. further argued that as the Appellant is entitled to the exemption available u/s. 65 it may be granted by this Tribunal in line with the verdict of the Hon'ble Supreme Court of Pakistan reported in **PTCL 2004 CL 494**, which says:-

> "…….it would be essential for the Tribunal to examine the scope of Section 65 *ibid*, and give clear verdict in the matter. It is correct that Federal Government is competent to exempt the sales tax in a case which is covered by the provisions of Section 65 of the Sales Tax Act, 1990, but the question regarding the entitlement of the benefit of said section, would need determination by an independent forum and we are of the view that the Tribunal having not attended the above fundamental question, has failed to exercise the jurisdiction vested in it and further the High Court while affirming the judgment of Tribunal, also committed the same error.".

10. The learned D.R. could not controvert the arguments advanced by the learned A.R. of the Appellant on the issue of exemption u/s. 65 except saying that pendency of the Appellant's Application u/s. 65 with the F.B.R. since long means that the F.B.R. does not want to extend exemption to the Appellant.

11. For correct appraisal of the issue of exemption, let us first examine the provisions of Section 65 of the S.T. Act, 1990. Section 65 of the S.T. Act, 1990 is reproduced as under:–

> "**65. Exemption of tax not levied or short levied as a result of general practice.** – Notwithstanding anything contained in this Act, if in respect of any supply the Federal Government is satisfied that inadvertently and as a general practice:–
>
> (a) tax has not been charged in any area on any supply which was otherwise taxable, or according to the said practice the amount charged was less than the amount that should have actually been charged;

(b) the registered person did not recover any tax prior to the date it was discovered that the supply was liable to tax; and

(c) the registered person started paying the tax from the date when it was found that the supply was chargeable to tax;

it may, by a notification in the official Gazette, direct that the tax not levied or short levied as a result of that inadvertent practice, shall not be required to be paid for the period prior to the discovery of such inadvertent practice.".

12. A bare perusal of Section 65 of the S.T. Act, 1990 envisages grant of exemption of the tax not levied or short-levied as a result of general practice subject to the following conditions:–

(a) tax has not been charged in any area on any supply which was otherwise taxable, or according to the said practice the amount charged was less than the amount that should have actually been charged;

(b) the registered person did not recover any tax prior to the date it was discovered that the supply was liable to tax; and

(c) the registered person started paying the tax from the date when it was found that the supply was chargeable to tax.

The power to grant exemption rests with the Federal Government.

13. For giving effect to the said provisions of Section 65, Para 50 of the Sales Tax General Order No. 3 of 2004, dated 12.06.2004 has laid down the following procedure:–

"(a) If a registered person claims that the supplies made by him during a certain period qualify for exemption under section 65 of the Sales Tax Act, 1990 he may make an application to the Collector having jurisdiction in the area where the registered person is located. The Collector will examine the case, collect relevant information from other Collectorates and if he is satisfied that the case falls within the scope of section 65, he will refer the same to the Revenue Division;

(b) Before making a reference to the Revenue Division the Collector will also fix responsibility on the staff who failed to detect that a taxable item is being cleared without payment of tax and thus caused loss of revenue. He will initiate disciplinary action, against the officials concerned and send a report to the Revenue Divisions;

(c) The case will be processed in the Revenue Division and if the conditions specified in section 65 are met the Federal Government may, by means of a notification in the official Gazette, exempt the said supplies from sales tax.

14. In the instant case, this Appellant moved the Application u/s. 65 on 28.12.2005 through the Collector (S.T.), Collectorate of Sales Tax & Federal Excise, Lahore, who reported to the learned Member, Sales Tax & Federal Excise, then C.B.R., Islamabad *vide* Letter C.N.I. & P/ST & FE/Compl/01/2006/342, dated 12.04.2006 that "the applicant does not qualify for exemption form sales tax under Section 65 of Sales Tax Act, 1990 on the following grounds:–

"(i) Legally, it was obligatory for the applicant to pay leviable sales tax on taxable supplies made by him. Furthermore, it was advertised from time to time by the Government through different notifications, print and electronic media that the retailers having annual turnover of more than Rs. 5 millions are required to get themselves registered with the Sales Tax Department and to pay sales tax on the sales.

(ii) Many other retailers like M/s. Jalal Sons, M/s. Body Shoes and M/s. Raja Sahib etc. are paying leviable sales tax on taxable sales tax on taxable supplies made by them.

(iii) Ignorance of law is no excuse. Furthermore, the issue of sales tax registration has been given vide publicity by the Government.".

15. As the F.B.R. has not yet taken any decision on the Application u/s. 65 despite a lapse of more than five years, this Tribunal is empowered to adjudicate upon the issue of exemption adhering to the verdict of the hon'ble Supreme Court of Pakistan reported in PTCL 2004 CL 494, in which the hon'ble apex Court has held as under:–

> "The above questions having direct link with the claim of benefit of Section 65 of the Sales Tax Act, 1990 would be the pivotal questions for determining the liability of the petitioner and the entitlement for statutory benefit. The Tribunal and also the learned Judges in the High Court, without dealing with the above fundamental questions involved in the case, non-suited the petitioner and left him at the mercy of departmental authorities for decision of the question of entitlement for the benefit of Section 65 of the Sales Tax Act, 1990 in their discretion.".
>
> "The learned Deputy Attorney General in the light of the observation of the High Court and also the Tribunal, has submitted that for the claim of benefit of Section 65 *ibid*, CBR was the proper forum and the petitioner could conveniently, approach the Collector concerned who having satisfied himself could competently refer the matter to the CBR with his recommendation for exemption of the relevant supplies from sales tax.".

> "The perusal of record would show that the Collector concerned initiated the process of issuing show cause notice raising the presumption that petitioner was responsible for evasion of sales tax, therefore, no useful purpose would be served in undertaking the exercise of approaching the Collector for grant of benefit of Section 65 of Sales Tax Act, 1990. In the light of facts and circumstances of the case and the observation of the Tribunal and also of the High Court on the question, it would be essential for the Tribunal to examine the scope of Section 65 *ibid*, and give clear verdict in the matter. It is correct that Federal Government is competent to exempt the sales tax in a case which is covered by the provisions of Section 65 of the Sales Tax Act, 1990 but the question regarding the entitlement of the benefit of said section, would need determination by an independent forum and we are of the view that the Tribunal having not attended- the above fundamental question, has failed to exercise the jurisdiction vested in it and further the High Court while affirming the judgment of Tribunal, also committed the same error.".

16. Grounds of exemption claimed by this Appellant and rebuttal of these Grounds by the Department are put together as under:–

Appellant's Grounds	Rebuttal by the Department
(i) he did not levy and pay the sales tax inadvertently as a result of general practice upto 30.06.2005;	(i) Legally, it was obligatory for the applicant to pay leviable sales tax on taxable supplies made by him. Furthermore, it was advertised from time to time by the Government through different notifications, print and electronic media that the retailers having annual turnover of more than Rs. 5 millions are required to get themselves registered with the Sales Tax Department and to pay sales tax on the sales.
(ii) he got his business of "C-Mart(s)" registered under the Sales Tax Act, 1990 on being apprised of the fact that he was liable to be registered.	(ii) May other retailers like M/s. Jalal Sons, M/s, Body Shoes and M/s. Raja Sahib etc. are paying leviable sales tax on taxable sales tax on taxale supplies made by them.
(iii) he has been paying the sales tax from the date when it was	(iii) Ignorance, of law is no excuse. Furthermore, the issue of sales

found that the supply was chargeable to tax.	tax registration has been given vide publicity by the Government.

When viewed in the light of the provisions of Section 65 of the S.T. Act, 1990, the rebuttal by the Department seems to be whimsical, arbitrary and injudicious.

17. We fully subscribe to the proposition that the provisions granting exemption are to be strictly construed, but it is equally true that a benefit conferred by law subject to certain conditions cannot be withheld if the conditions are complied with/satisfied, and such benefit cannot be disallowed merely on the basis of conjectures and surmises. When liberal construction of the provisions granting exemption is not permissible in favour of the Tax-payer, the Department cannot be allowed to disallow exemption leisurely, arbitrarily and whimsically.

18. The Department did admit in the Para-wise Comments filed with the learned Collector (Appeals) that neither the Appellant, nor his predecessor ever charged the sales tax, and that they were not apprised by the Sales Tax Department that the sales tax ought to have been charged on the supplies made by the C-Marts.

Non-levy and non-payment of sales tax by all the persons engaged in a business gives rise to a general practice. The Department has erred in comparing this Appellant's case with M/s. Jalal Sons, M/s. Body Shoes and M/s. Raja Sahib, Lahore. The case of this Appellant is comparable only with the convenience stores on the filling stations throughout the country. The Department has not been able to quote even a single case of convenience store, which voluntarily paid sales tax, or which was subjected to sales tax like this Appellant, which means that this Appellant did not charge and pay the sales tax as a general practice prevailing among the parallel cases of convenience stores. The first condition laid down by Section 65(a) that “tax has not been charged in any area on any supply which was otherwise taxable” is fully satisfied. *Hence*, it is held that this Appellant did not levy and pay the sales tax inadvertently as a result of general practice up to 30.06.2005.

19. As regards the 2nd condition contained in Section 65(b) of the S.T. Act, 1990 that “the registered person did not recover any tax prior to the date it was discovered that the supply was liable to tax”, the Department has not brought on record any evidence that this Appellant recovered any sales tax from the Tax Periods 02/2001 to 06/2005. The second condition of exemption is thus also satisfied.

20. Now we come to the 3rd and last condition imposed by Section 65(c) of the S.T. Act, 1990 that “the registered person started paying the tax from the date when it was found that the supply was chargeable to tax”. This last condition also stands complied with. On being apprised by the Department, this Tax-payer got himself registered under the S.T. Act,

1990 w.e.f. 24.12.2005, and started paying sales tax since 07/2005, and he has been faithfully discharging his sales tax liability till date under the Sales Tax Special Procedure Rules, to which the Department has never raised eye-brow.

21. As this Appellant/Tax-payer's case of exemption is fully covered by the provisions of Section 65 of the S.T. Act, 1990, we find no hesitation in holding that this Appellant/Tax-payer is fully entitled to the exemption of the sales tax not levied by him upto 30.06.2005 inadvertently and as a result of general practice. The demand of Rs. 14,983,892 (alongwith default surcharge) raised through the impugned O-in-O No. 08/2006, dated 18.02.2006, and upheld by the Collector (Appeals) *vide* the impugned Order-in-Appeal No. 177/ST/2006, dated 21.06.2006, is set at naught, and the impugned Orders are annulled.

22. As the fate of this appeal stand determined as a result of adjudication of the issue as to the exemption u/s. 65 of the S.T. Act, 1990, there is no need to dilate on the other issues urged before us.

23. This appeal succeeds in the manner as indicated above.

2012 PTR 438 (H.C. Pat.)

HIGH COURT OF PATNA

Samarendra Pratap Singh, J.

1. Chief Commissioner of Income Tax (CCA), Patna
2. The Director General of Income Tax (Inv.) 9, Bailey Road, Patna through its Deputy Secretary
v.
1. The State of Bihar through The Chief Secretary Govt. of Bihar
2. The Bihar Human Rights Commission Patna through Deputy Secretary.
3. Rajendra Singh

FACTS/HELD

1. **Interrogation till late night amounts to "torture" & violation of "human rights"**
2. The assessee's premises were searched u/s 132 and alleged undisclosed income of Rs. 4.18 crores was detected. The assessee filed a complaint before the the Bihar Human Rights Commission stating that interrogation & recording of statement was conducted for more than 30 hours and till the odd hours of the night without any break or interval and this violated his human rights. The Commission upheld the plea and directed the concerned officials to show-cause why the assessee should not be compensated from their salary. The Department filed a Writ Petition to challenge the order. HELD by the Court:
   (i) The interrogation continued till 3.30 a.m. on the second night of search and seizure as per the department's record. The **search and seizure manual does not prescribe any time limit for search and survey operation and the same may continue for days if required, but it has to be in keeping with the basic human rights and dignity of an individual**. The purpose of the Act is to give effect to the process of execution of actions of executive and bureaucratic machinery in line of accepted standard of basic human

rights which are internationally recognized. The laws, and approach to law for its execution must confirm to the charter of human values and dignity. Even a person accused of a serious offence has to be produced before the nearest Magistrate within 24 hours minus the time taken in reaching the Court. **There is no possible justification to continue interrogation and keep the assessee awake till 3 a.m. on the second night of search and interrogations. No reason has been assigned as to why the interrogations could not have been deferred till the morning of the next day**. The officials could have continued with the interrogation on the next day in the morning after allowing the assessee to retire at an appropriate time in the night. **Sleep deprivation method of interrogation amounts to inhuman treatment and violation of Article 3 of the European Convention on Human Rights**. The Convention prohibits in absolute terms torture or Inhuman or degrading treatment or punishment. No exception to Article 3 can be made even in the event of Public Emergency threatening the life of the Nation. Accordingly, **the department is guilty of violating human rights even though the operations were conducted in best interest of revenue and good faith (Ireland vs. UK** (1978) ECHR 1, **Kalashnikov vs. Russia** (2002) ECHR 596 & **Salmouni vs. France** (2000) 29 EHRR 403 followed; **Rajendran Chingaravelu** 2010(1) SCC 45 distinguished)

(ii) However, as the Commission, without issuing any notice to the officials engaged in the search (as to the violation of Human Rights), issued notice on why monetary compensation be not awarded and be recoverable from their salary, **it had pre-judged the officials as being guilty of violation of human rights, without affording them an opportunity of hearing**. This was contrary to s. 16 of the Protection of Human Rights Act, 1993 and had to be reversed.

Application partialy allowed.

Civil Writ Jurisdiction Case No.10707 of 2011.
Decided on: 2nd February, 2012.
Present at hearing: Sandeep Kumar, Alok Kr. Shahi, Advocates, for petitioner. K.P. Gupta, for Respondent. Mrigank Mauli, Advocate, for Respondent No. 3.

JUDGMENT

Per Samarendra Pratap Singh, J.–

The present writ petition has been filed against the order dated 28.4.2011 passed by the Chairperson, Human Rights Commission by which the learned Commission has held that there has been violation of human rights of respondent no.3 (Rajendra Singh) by the concerned officials of the Income Tax Department while continuing search and seizure operation, for which he would be entitled to monetary compensation and has further asked the department to submit its response as to why the monetary compensation be not awarded to the applicant recoverable from the salary of the concerned officials of the department.

2. One Rajendra Singh made a complaint before the Bihar State Human Rights Commission (hereinafter referred to as „the Commission‟) that during the search and seizure operation the raiding party committed various acts of omission and commission including violation of his human rights. Some of the broad features of the complaint which is also summarized in paragraph 2 of the writ petition are as follows:

i) The officials of the Income Tax Department confined them in their house for two days in course of search and seizure operation in their business and residential premises almost uninterruptedly.

ii) The search team confined his family members and did not allow him to cook food, thereby compelling them to purchase the same from outside.

iii) The members of the search team misbehaved, abused and tortured respondent no.3 and his family members.

iv) The members of the search team used methods of coercion for recording statements and obtaining signatures forcibly.

v) The members of the search team hurt the religious sentiments of the Sikh community by throwing buts of used cigarettes on the photograph of Golden temple and Sikh Guru

vi) The members of the search team stole two Mobile Phones before leaving the premises.

A copy of the complaint petition is at Annexure-1.

3. The Commission issued show cause notice to the Income Tax Department to reply to the allegations of respondent no.3. The

department filed its reply and report on 25.11.2010 and 3.2.2011. The reply of the department is contained in Annexure-2 series. The Commission came to a finding that there was continuous interrogation without a break for more than 36 hours commencing at 9.30 A.M. on 8.9.2010 and the first break was given only at 3.30 A.M. on 10.9.2010 forcing the applicant and his family members to remain awake at hours which was meant for sleeping. The continuous interrogation at odd hours in night is a torturous act being violative of basic human rights of an individual. The Commission broadly agreed that the department if need be may conduct such search and seizure operation for days together but then they have to stop the same at proper time and resume again at an appropriate time in the morning. The Commission observed that the search and seizure operation have to be carried out keeping in view the basic human rights of an individual as every individual has inherent human rights which ought not to be infringed upon.

4. Being aggrieved by the order of the Commission, the petitioners have preferred this writ petition mainly on the grounds mentioned hereinbelow:

i) The order of the learned Single Member is without jurisdiction being Coram non-judice. In short, in absence of any rules and regulations prepared by the State or the Commission, the order could have been passed only by all the three members sitting together and not by an individual member.

ii) The complainant had not come to this court with clean hands as he had filed a complaint before the NHRC, National Commission of Minorities and the criminal case being Jakkanpur P.S. Case no.246 of 2010.

iii) The Commission ought not to have heard the matter as the department had preferred Cr. Misc. No.43811 of 2010 for quashing of the F.I.R. and the criminal case itself being sub-judice before the Chief Judicial Magistrate, Patna.

iv) The Commission ought not to have held the concerned officials of the Income Tax guilty of violating human rights without affording an opportunity of hearing them personally under section 16 of the Protection of Human Rights Act, 1993 (hereinafter referred to as "the Act, 1993").

v) The officer had acted in good faith and in discharge of their official duty.

vi) The Commission erred in holding that the complainant was not given sufficient break as it was not possible for one officer to keep interrogating for 42 hours. Further more, the search and seizure manual permitted continuous interrogation.

5. The petitioners in support of their submissions relied upon the case of *Rajendran Chingaravelu vs. R.K. Mishra, Addl. CIT & Ors*, reported in (2010) 1 SCC 457, wherein the Hon'ble Apex Court did not find any fault with long detention and interrogation of appellant.

6. The petitioners in short submitted that the search operation resulted in disclosure of undisclosed income of Rs.86,66,220/- from respondent no.3 and Rs.4,81,66,220 in total from all the four brothers including respondent no.3. The search and seizure protected the interest of the State and revenue.

7. Now I will take up the points raised by the petitioners one by one.

Refer: Issue No.(i): The order of the learned Single Member is without jurisdiction being Coram non-judice.

The petitioners have argued that the Hon‟ble Chairperson sitting singly was not competent to hear the complaint of violation of human rights. According to them, all the three members of the Commission sitting together could have heard the complaint.

On the other hand, counsel for respondent no.3 submits that the doctrine of Coram non-judice speaks about inherent or complete lack of jurisdiction in respect of subject matter which would not be the case here. All other questions are but an "exercise of jurisdiction". He relied upon decisions in the case of *Hiralal Patni vs. Srikalinath*, reported in A.I.R. 1962 SC 199 Para 4 and in the case of *Official Trustee West Bengal & Ors vs. Sachindranath Chatterjee & anr*, reported in A.I.R. 1969 SC 823 paragraphs 13, 14 and 15. He submits that the question relating to pecuniary or territorial jurisdiction would not make an order Coram non-judice.

8. Before I deal with the issue, it would be relevant to notice some of the provisions of the Protection of Human Rights Act, 1993 (hereafter referred to as „the Act, 1993). Section 29 of the Act states that the provisions of sections 9, 10, 12, 13, 14, 15, 16, 17 and 18 shall apply to State Commission. Section 10 confers power on the Commission to lay down by regulations its own procedure. Section 40-B confers power on Commission to make regulations to carry out the provisions of the Act including procedure to be followed by Commission under section 10(2). Section 10(2) of the Protection of Human Rights Act, 1993 read as under:

> "10. Procedure to be regulated by the Commission- (1) The Commission shall meet at such time and place as the Chairman may think fit.
>
> (2) Subject to the provisions of this Act and the rules made thereunder, the Commission shall have the power to lay down by regulations its own procedure".

In exercise of power under section 10(2) read with section 40-B, the National Human Rights Commission (in short ‟NHRC‟) has made

regulations being the National Human Rights Commission (Procedure) Regulation, 1994. Rule 8 lays down the procedure for dealing with the complaint. Sub-rule(1) of Rule 8 lays down the criteria for a case to be taken by a Single Member bench or bench of two members or more than two members. Rule 8(1) is quoted hereinbelow for each reference.

> "8. Procedure for dealing with complaints – (1) All complaints in whatever form received by the Commission, shall be registered and assigned a number and placed for admission as per the special or general directions of the Chairperson before a Single-Member Bench constituted for the purpose, not later than one week of receipt thereof. If the Single-Member Bench dealing with the case, either for admission or for final disposal, having regard to the importance of the issues involved, is of the opinion that the case should be heard by a Bench of not less than two Members, he/she may refer the case to a Bench of two Members. On receipt of the reference, the case shall be assigned to a Bench of two or more Members, as may be constituted by the Chairperson, Ordinarily, complaints of the following nature are not entertainable by the Commission:–
>
> (a) in regard to events which happened more than one year before the making of complaints;
>
> (b) with regard to matters which are sub-judice;
>
> (c) which are vague, anonymous or pseudonymous;
>
> (d) which are of frivolous nature; or (e) those who are outside the purview of the Commission.

9. From bare perusal of the regulation, it appears that rule 8(1) of Regulations, 1994 contains the procedure for dealing with a complaint by a Commission. It states that a Single Member bench dealing with complaint may refer the matter to a bench of two members, or more than two members if he considers that the issue is of considerable importance to be heard so. On receipt of reference, the case shall be assigned to a bench of two or more members, as may be constituted by Chairperson. In such circumstances, it cannot be said that the Single Member Bench is not competent to hear a complaint regarding violation of human rights.

10. Furthermore, the matter is one of procedure and not of jurisdiction. The respondent no.3 has rightly relied upon the case of Hiralal Patna (supra) and Official Trustee West Bengal & Ors (supra). The Hon"ble Apex Court in cases referred above, observed that if a court has jurisdiction to try a case and has authority to pass an order of a particular kind, the fact that it has passed an order which it normally should not have made in the given circumstances would not indicate total want or loss of jurisdiction so as to render the order nullity. Thus, I reject the contention of the petitioner that the order passed by the learned Single Member was without jurisdiction.

11. **Refer: Issue No. (ii) &(iii):**

(ii) The complainant did not disclose in his complaint before the State Human Rights Commission that it has filed a complaint before the NHRC, National Commission of Minorities and also lodged a criminal case being Jakkanpur P.S. Case No.246 of 2010.

(iii) The Commission ought not to have heard the matter as the department had preferred Cr. Misc. No.43811 of 2010 for quashing of the F.I.R. and the criminal case itself being sub-judice before the Chief Judicial Magistrate, Patna.

Answer: The National Commission of Minorities or a Criminal Court exercises different jurisdictions. One single incident may have wide ramifications e.g. a person apart from being proceeded for intrusions of right of a minority, can also be proceeded for violation of human rights as well as for committing a penal offence, if the facts, so justify. The respective complaint to the National Commission of Minorities or to the police, addresses different and distinct concerns. Respondent no.3 ought to have mentioned in his complaint that he has written to the NHRC, which complaint was subsequently transferred to the SHRC. The non-mentioning of writing of such complaint to NHRC, which eventually is to be endorsed to the competent body e.g. SHRC would be an irregularity and in no way obviate or wipe off the act of violation of human rights. Thus though it is desirable that such facts are stated, the same cannot be a ground for rejection of the complaint filed before the State Human Rights Commission.

12. This takes us to issue nos. (iv), (v) & (vi) which are taken up together as they are inter linked:

iv) The Commission ought not have held the concerned officials of the Income Tax guilty of violating human rights without affording an opportunity of hearing to them personally under section 16 of the Act.

v) The officer had acted in good faith and in discharge of their official duty.

vi) The Commission erred in holding that the complainant was not given sufficient break as it was not possible for one officer to keep interrogating for 42 hours. Further more, the search and seizure manual permitted continuous interrogation.

The petitioners submit that Bhargo Saw Mill Compound is a huge compound of about 5000 Sq. ft. in area. The apartment comprises of four residential floors in which respondent no.3 and his other brothers live separately. The building also has an office of M/s Bhargo Saw Mills. The open area of the premises was used to store huge quantity of timber inside the residential premises. The two open premises across the road

was also used to store timber and another premise was rented out to a school. The petitioners submit that the search and seizure operation of such a large residential and business place would involve a large number of officers and staffs. Thus, the team included three authorized officers (2 Assistant Director) and one Income Tax Officer and 11 staffs to cover up the entire place to conduct the search and seizure operations. The same set of officers apart from conducting search and seizure had to prepare the inventory of books of accounts, documents, jewellery and cash etc. The petitioners submit that it would appear from perusal of the statement of respondent no.3 that the entire statement was recorded by a Single officer and not by a batch of officers and it is humanly impossible for an officer to continuously conduct interrogation for more than 30 hours. The petitioners submit that in fact only 31 questions were asked before allowing them rest for nearly 7 hours on assessee‟s request. The petitioners further submit that the search and seizure operation were conducted in two other business premises but there has been no complaint of violation of Human rights from any other partner or the brothers except respondent no.3. The petitioners submits that the case of *Pooran Mal vs. Director of Inspection (Inv)*, reported in 96 ITR 505(SC)(1974) would apply mutatis mutandis to searches made under section 41 of the Income-tax Act, 1922 now section 132 of the Income-tax Act, 1961. It is further the case of the petitioners that search and seizure is a temporary interference with right to hold the premises and the articles seized. They also state that any reasonable restrictions cannot be held to be unconstitutional. Reliance has been placed on the following passage from the case of *M.P. Sharma vs. Satish Chandra* which is quoted herein below:

> "A search & seizure is only a temporary interference with the right to hold the premises searched and the articles seized. Statutory regulation in this behalf is necessary and reasonable restriction cannot per se be considered to be unconstitutional".

The petitioners submit that in the case of *Rajendran Chingaravelu vs Mr. R.K. Mishra, Addl. CIT & Ors*, reported in 2010(1) SCC 457, the Hon‟ble Apex Court upheld the detention of the applicant for 15 hours who was carrying a cash of Rs.65 lacs along with a Bank certificate certifying the source and withdrawals. The Hon‟ble Apex Court observed that though the individual has right to carry money, the same is subject to verification or seizure by Intelligence authority to ensure that the said money is not intended for illegal activities. The Hon‟ble Apex Court further held as follows:

> "Any bonafide measures taken in public interest, and to provide public safety or to prevent circulation of black money, cannot be objected as interference with the personal liberty or freedom of a citizen".

13. Mr. Mrigank Mauli, learned counsel for respondent no.3 submits that the Commission found that the search and seizure operation commenced at 9.30 A.M. on 8.9.2010 and he was continuously interrogated for 36 hours till 10 P.M. on 9.9.2010. He further submits that the Commission noted that though the exact time of commencement of interrogation is not mentioned in the statement but question no.15 gives an idea about the duration. The officer interrogating respondent no.3 while asking question no.15 told the applicant that he was being asked to produce books of accounts, but despite passage of more than 36 hours, the same had not been produced. Learned counsel further submits that the Commission rightly observed that the operation commenced at 9.30 A.M. on 8.9.2010 and the question no.15 was being asked about 10 P.M. on 9.9.2010. Further, it would appear from question no.16 that three hours additional time was granted to the respondent no.3 to produce the records and the expiry time was mentioned as 1 A.M. of (10.9.2010). He submits that the Commission noticed that recording of statement was temporarily suspended to be resumed in the morning after 31st question at 3.30 A.M. on 10.9.2010. The date and time has been endorsed by the officer along with his signature.

14. Controverting the stand of respondents, the department submits that in fact only 15 questions were asked by 10 P.M. on 9.9.2010 would show that interrogation was not long enough and there were temporary breaks in between. He submits that the search and seizure manuals do not lay down any time limit of search and seizure operation.

15. The Commission held that interrogation and recording of statement at odd hours in the night of 9/10.9.2010 was in violation of basic human rights of an individual which obviously would cause physical and mental torture. The department cannot force an individual to remain awake when it is a time for sleep.

16. The respondent no.3 submits that the order of the Commission is in consonance with the objectives and purpose for which Protection of Human Rights Act, 1993 has been enacted. He submits that all laws must confirm to the charter of human values and dignity. In support of his submission, he relied upon a decision in the case of *Ireland vs the United Kingdom*, reported in (1978) ECHR 1 and in the case of *Kalashnikov vs Russia*, reported in (2002) ECHR 596.

17. It appears that the learned Commission has concluded that question no.15 would show that despite passage of more than 36 hours, the books of accounts were not produced. The Commission as such inferred that the question was being asked at about 10 P.M. on 9.9.2010, as the operation had begun on 8.9.2010 at 9.30 A.M.. The Commission was of the view that in case if a break was given, the same would have been duly entered in the record. The Commission observed that it becomes evident from question no.16, that 3 hours further time was granted to produce the books of accounts, which time would expire at 1

A.M. on 10.9.2010. The Commission also noticed that the temporary break was given only after 31st question, which concluded at 3.30 A.M. on 10.9.2010.

18. The non-mentioning of breaks in the record may not be conclusive proof of the fact that interrogation and search operation continued unabated for more than 36 hours. It may also not be humanly possible for an official to interrogate continuously for 36 hours. However, one fact remains undisputed that the interrogation continued till 3.30 A.M. on the second night of search and seizure as per the own record of department. The search and seizure manual of the Income Tax does not prescribe any time limit for search and survey operation and the same may continue for days if required, but it has to be in keeping with the basic human rights and dignity of an individual. The purpose of the Act is to give effect to the process of execution of actions of executive and bureaucratic machinery in line of accepted standard of basic human rights which are internationally recognized. The laws, and approach to law for its execution must confirm to the charter of human values and dignity. Even a person accused of a serious offence has to be produced before the nearest Magistrate within 24 hours minus the time taken in reaching the Court. There is no possible justification to continue interrogation and keep the respondent no.3 awake till 3 A.M. on the second night of search and interrogations. No reason has been assigned as to why the interrogations could not have been deferred till the morning of the next day. The officials could have continued with the interrogation on the next day in the morning after allowing respondent no.3 to retire at an appropriate time in the night. Respondent no.3 has rightly relied upon the decisions rendered in the case of *Ireland vs. United Kingdom* (supra), where in the court held that sleep deprivation as part of methods of interrogation amounted to inhuman treatment and violation of Article 3 of the European Convention on Human Rights. In the case of Kalashnikov (supra), the European Court of Human Right (in short "ECHR") noticed that the complaint related to lack of facility to the prison inmates on account of shortage of which, the inmates slept taking turns, while one slept the others would lie or sit on the floor and card boxes. In case of *Salmouni vs France*, reported in (2000) 29 EHRR 403, the court went to the extent of stating that Convention prohibits in absolute terms Torture or Inhuman or Degrading Treatment or Punishment and went on to the extent of stating that no exception to Article 3 can be made even in the event of Public Emergency threatening the life of the Nation. The human rights belong to all of us equally and would apply no less to an intruder of law, as to a law enforcing agency.

19. The term „human rights" has been defined in section 2(d) of 1993 Act as the right relating to life, liberty, quality and dignity of the individual granted by the Constitution as provided in Part III of the Constitution and as embodied in International Covenants. The

International Covenants has been defined in section 2(f) of the Act which means International covenants on civil and political rights and international covenants on economic, social and cultural representations adopted by the general assembly of the United Nation. Article 7 of the International Covenant on Civil and Political Rights states that no one shall be subject to torture or to cruel inhuman or degrading treatment or punishment. Article 10(1) states that all persons deprived of liberty shall be treated with humanity and with respect to inherent dignity of human person. The word “Torture” has been defined in the ‘Convention Against Torture and other cruel, inhuman or Degrading treatment or punishment’. in Article-1, which reads as follows:

> “For the purposes of this Convention, the term Torture means any act by which severe pain or suffering, whether physical or mental, is intentionally inflicted on a person for such purposes as obtaining from him or a third person information or a confession, punishing him for an act he or a third person has committed or is suspected of having committed, or intimidating or coercing him or a third person, or for any reason based on discrimination of any kind, when such paid or suffering is inflicted by or at the instigation of or with the consent or acquiescence of a public official or other person acting in any official capacity……”

The preamble specifically provides that while drafting the said Convention, regard had been made to Article 5 of the Universal Declaration of Human Right and to Article 7 of the International Covenant on Civil and Political Rights, as the same are in recognition of the universal respect for an observance of Human Rights and fundamental freedoms.

20. Even assuming that there were temporary breaks in course of interrogation which continued for 42 hours, it is not in dispute that even on the second night of search and survey on 10.9.2010, the interrogations continued till 3 A.M. and the respondent no.3 and his family members were made to remain awake when it was time for sleep. No cause has been shown as to why it was necessary to continue the interrogations till deep in the second night of interrogations. The case relied by the department in the case of Rajendran Chingaravelu (supra) would not be of much help, as in the aforesaid case the petitioner was detained for 15 hours on the first day itself, as he was carrying Rs.60 lacs at the Airport which could have been used for the illegal activities In the instant case, the interrogation have continued for 42 hours and undisputedly at the odd hours of second night, which could easily have been avoided and deferred. No reason has been recorded for not deferring the interrogation till morning.

21. The department would consider issuing appropriate instruction in future raids to record the duration of interrogation and breaks.

22. I am in agreement with the submissions of the petitioners that if required, the search and seizure can continue for days but at the same time due regard to human dignity and value cannot be ignored. In the instant case, no reason has been assigned as to why it was absolutely imperative to continue with the interrogations at 3 A.M. on 10.9.2010, when search and seizure has commenced on 8.9.2010 at 9.30 A.M. Even if I agree with the submissions of petitioners that there were breaks and there were no continuous interrogation for 36 hours as held by Commission, still the department has no plausible excuse for making interrogations till odd hours of second night till 3 A.M. Thus I partially affirm the order of learned Commission holding the department guilty of violating human rights but only to the extent indicated in paras 18 and 22. I am conscious of the fact that the efforts of the team led to unearthing of undisclosed income from petitioner and his three brothers totaling over Rs.4,81,00,000/-. I even agree with the submissions of petitioners that operations were conducted in best interest of revenue and good faith.

23. The other aspect is that the learned Commission has not issued any notice to the officials/staff engaged in search, seizure and interrogation. Nonetheless the Commission has issued notice to them to submit their response as to why monetary compensation be not awarded and be recoverable from the salary of the concerned officials. The issuance of such notice would tantamount to pre-judging the officials/staff engaged in search and seizure operation of being guilty of violation of human rights, without affording them an opportunity of hearing. Section 16 of the Protection of Human Rights Act, 1993 prohibits passing of an order by the Commission which may prejudicially injure the reputation of a person without providing a reasonable opportunity of being heard in the enquiry and to produce the evidence in his defence. Section 16 is quoted herein below for easy reference:

> "16. Persons likely to be prejudicially affected to be heard- If, at any stage of the inquiry, the commission–
>
> > (a) consider it necessary to inquire into the conduct of any person; or
> >
> > (b) is of the opinion that the reputation of any person is likely to be prejudicially affected by the inquiry,
>
> it shall give to that person a reasonable opportunity of being heard in the inquiry and to produce evidence in his defence: Provided that nothing in this section shall apply where the credit of a witness is being impeached".

24. In the instant case admittedly no notice has been issued to the individual officials who now by the impugned order have been asked to submit their response as to why monetary compensation be not awarded from their salary. The law at the first instance prohibits the very passing

of an order adjudging an individual guilty of violation of human rights without affording an opportunity of hearing. Only when an individual is first judged to be guilty of violation of Human Rights, the question of inflicting penalty would arise. In the instant case, no opportunity was given to the officials to countenance the charge of violation of human rights. In absence of an opportunity to defend themselves against such charge in an enquiry, the learned Commission erred in issuing notice to the officials to show cause or respond as to why penalty may not be levied for awarding compensation to the complainant and is accordingly quashed.

25. As held in the foregoing paragraphs, I affirm the findings of the learned Commission that the Income Tax Department violated Human Rights of the complainant (Respondent No.3) but only to the extent indicated in this order.

26. In the result, this writ application is only partially allowed so far response of officials were sought for levying monetary penalty; it‟s challenge against findings of violation of Human Rights is dismissed.

2012 PTR 450 (Trib. Ind.)

INCOME TAX APPELLATE TRIBUNAL
BANGALORE "A" BENCH, BANGALORE

N Barathvaja Sankar, Vice President and George George K, Judicial Member

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FACTS/HELD

1. **TPO can rely on "contemporaneous" data even if not available at specified date**
2. In a transfer pricing appeal, the Tribunal had to consider two issues: (a) what is the data to be considered by the TPO at the time of determining ALP? & (b) whether the assessee should be given an opportunity to refute the material sought to be utilized by the TPO? HELD by the Tribunal:
   (i) Under Rule 10D (4) the information and documents should as far as possible be contemporaneous and should exists latest by the 'specified date' specified in s. 92F (4) i.e. the due date for filing the ROI. **There is no cut-off date upto which only the information available in public domain can be taken into consideration by**

the TPO while making the transfer pricing adjustments and arriving at the ALP. The assessee's argument that s.92D and Rule 10D is defeated if the TPO takes the data which is available in the public domain after the specified date is not acceptable.

(ii) While the TPO is empowered by s. 131(1) & 133(6) to call for information without informing the assessee about the process, he cannot use such information against the assessee without giving the assessee a reasonable opportunity of hearing. If the assessee seeks an opportunity to cross-examine third parties, it has to be given the opportunity (Genisys Integrating Systems followed)

Appeal partly allowed.

ITA No.1413/Bang/2010 (Assessment Year 2006-07).

Heard on: 7th December, 2011.

Decided on: 27th January, 2012.

Present at hearing: Padam Chand Khincha, C.A., for Appellant. Etwa Munda, CIT-III, for Respondent.

JUDGMENT

Per George George K:– (Judicial Member)

This appeal instituted by the assessee is directed against the assessment completed u/s 143(3) r.w.s 144C of the I T Act, 1961. The relevant asst. year is 2006-07. The assessee is aggrieved by the order of the Dispute Resolution Panel (DRP) dated 20/9/2010. The DRP had issued directions under sub-section (5) of section 144C read with sub-section (8) of section 144C of the Act. The DRP had approved, but for minor modification, the draft order of assessment making transfer price adjustment as suggested by the Transfer Pricing Officer (TPO) u/s 92CA of the Act.

2. The assessee has raised the following concise grounds:–

The lower authorities (the Ld. AO, Ld. TPO and Hon'ble DRP) have erred in–

i) passing the order disregarding the principles of natural justice;

ii) making a reference to Transfer Pricing Officer for determining arm's length price;

iii) passing the order without demonstrating that appellant had motive of tax evasion;

iv) not appreciating that the members of Dispute Resolution Panel also being jurisdictional Commissioners/Director of Income Tax of the appellant, the constitution of the DRP is bad in law;

v) not appreciating that the charging or computation provision relating to income under the head “profits and gains of business or profession” do not refer to or include the amounts computed under Chapter X and therefore the addition under Chapter X is bad in law;

vi) adopting a flawed process of issuing notices u/s 133(6) and relying on the same without providing complete information to the appellant or an opportunity to cross examine the parties involved;

vii) rejecting comparables and transfer pricing analysis of the appellant on unjustifiable grounds;

viii) doing fresh transfer pricing analysis and adopting inappropriate filters in such analysis;

ix) considering the data which was not available to the appellant at the time of complying with the TP documentation requirements;

x) selecting inappropriate comparables and rejecting appropriate comparables;

xi) inappropriately computing the operating margins of comparables and the appellant;

xii) not making proper adjustment for enterprise level and transactional level differences between the appellant and the comparable companies;

xiii) not appreciating that the law does not compel adopting many (or any minimum) companies as comparables and that the appellant could justify the price paid/charged on the basis of any one comparable only;

xiv) not allowing the benefit of the +/-5% range as per the proviso to section 92C(2);

xv) not excluding the telecommunication charges from the total turnover while excluding the same from export turnover while computing deduction u/s 10A; &

xvi) levying a sum of Rs.30,51,668/- as interest under section 234B and a sum of Rs.19,2222/- as interest under section 234D.

3. Brief facts of the case are as follows:–

> The assessee is an Indian Company, a subsidiary of Kodiak Networks Inc., USA. It is engaged in the business of software development service to Kodiak Networks Inc, USA. The return of income for concerned asst. year was filed on 28/11/2006 declaring an income of Rs.11,97,597/-. The return of income was taken up for scrutiny and the case was referred to TPO u/s 92CA for determination of arm's length price. During the year, the assessee company had the following international transactions with its Associate Enterprise (i) rendering of software development services; (ii) marketing and customer support services; (iii) purchase of capital goods; (iv) sale of capital goods; and (v) reimbursement of expenses. There is no objection by the TPO on the pricing of the international transactions with respect to marketing and customer support services, purchase and sale of capital goods and reimbursement of expenses. The TP adjustment has been made only with respect to rendering of software development services to the tune of Rs.1,73,67,933/-.

4. The Assessing Officer forwarded a draft of the proposed order of assessment to the assessee on 17/12/2009 and served on the assessee on 24/12/2009. After receiving draft assessment orders, the assessee filed its objections before the DRP on 22/01/2010. The DRP has issued notice u/s 144C(11) of the Act dated 22/06/2010 and one opportunity of hearing was given on 11/8/2010 and the DRP vide its order dated 20/09/2010 upheld the TPO/AO's transfer pricing adjustment with minor modification in regard to M/s Megasoft Ltd.

5. Being aggrieved with the direction of the DRP, the appellant company ['the appellant' in short] has come up with the present appeal. During the course of hearing, the Ld. A.R argued, touching various aspects and also filed two written submissions, the substances of the second written submissions are summarized as under:

> (1) The appellant rendered software development services wholly to its AE. The total value of software development service was Rs. 24,06,82,087/-.

The appellant adopted Transactional Net Margin Method (TNMM) to justify the price charged in the international transactions. The appellant conducted a methodical search process on Prowess database to identify comparable companies. After adopting various search filters, the appellant selected 49 companies as comparables. The arithmetic mean of these comparables was 11.01%. The appellant's operating margin on cost was 10.70%. Since the appellant's margin of 11.01% was within the 5% range as provided in proviso to s. 92C (2), it was concluded that the international transactions relating to software development services are at arm's length.

In the final Order passed u/s 92CA, the TPO selected 20 companies as comparables. The TPO considered 6 additional companies as comparables (apart from 14 companies as proposed in the show-cause notice). These six new companies were adopted as comparables without proposing the same in the notice or affording an opportunity to the appellant to present its objection to their adoption. The arithmetic mean was determined at 20.68%. After factoring a working capital adjustment of 1.55%, the adjusted arithmetic mean was determined at 19.13%. The transfer pricing adjustment for the software development services was accordingly determined at Rs. 1.74 crores.

The appellant filed detailed objections with the DRP which have been rejected by DRP except for correcting an error in the margin computation of one comparable, namely, Megasoft Limited and that the Order of the DRP was brief. The AO accordingly incorporated the TP adjustment, while determining the total income.

TURNOVER FILTER:

(2) In its transfer pricing analysis, the appellant had adopted the lower turnover criteria to select the comparables. During the proceedings u/s 92CA, the appellant submitted that if the lower turnover filter was to be applied, then the upper turnover filter limit of Rs. 200 crores should be applied. The TPO had applied a lower turnover filter of Rs. 1 crore on the ground that there was no relationship between sales and margins to apply the upper turnover limit.

The appellant submitted that size of the comparable was an important factor in comparability. This was also recognised by the statute i.e., rule 10B (3) lays down guidelines for comparing an uncontrolled transaction with an international transaction.

(3) Differences for transfer pricing purposes can be of two types: (i) differences in transactions being compared or (ii) differences in enterprises. A comparable should be rejected if any of the above difference materially affects the price charged or cost paid, or profit arising, from such transactions in the open market unless an accurate adjustment can be made for removing the effect of such differences.

While applying any of the methods, the Rule provides an adjustment being effected for ironing out the enterprise wide differences. The TNMM (which is adopted by the TPO as the most appropriate method in the instant case), for e.g., contemplates an adjustment for an enterprise wide difference (Rule 10B(1)(e)).

Rule 10B (3) outlines various conditions for comparability that in judging whether an uncontrolled transaction is comparable, the enterprise level differences will have to be reckoned. In choosing the most appropriate method, Rule 10C (2)(e) factors the ability of making reliable and accurate adjustment to account for the differences in the enterprises levels.

Size is an important facet of an enterprise level difference. Size of an enterprise is thus to be examined for comparability purposes. Significant differences in size of companies would impact comparability. Comparable means something that is similar or equivalent. It is something which possesses the same or almost the same characteristics. It is not that every company in the industry becomes a comparable. To use a simile, a Maruti 800 car cannot be compared to Benz car. In business, size matters. Unusual patterns, stray cases, wide disparities have to be eliminated as they don't satisfy the test of comparability.

Companies operating on a large scale benefit from economies of scale, higher risk taking capabilities, robust global delivery and business models as opposed to the smaller or medium-sized companies. Size therefore matters. Two companies of dissimilar size therefore cannot be assumed to earn comparable margins. Impact of difference in size could be removed by a quantitative adjustment to the margin or price being compared, if it is possible to do so reasonably accurately. Otherwise the uncontrolled transactions may have to be rejected from the comparability exercise. It is generally difficult to quantify mathematically, the impact of size on margins.

Companies of dis-similar sizes therefore are not to be compared. Size as one of the selection criteria has also been approved by various benches of ITATs. The Chandigarh S. B of ITAT in the case of *DCIT vs. Quark Systems Pvt Ltd* 38 SOT 207 has specifically rejected adoption of the turnover range of one crore on lower end and infinity on the higher end.

Relies on the case laws:

- *Egain Communications Private Limited vs ITO* 118 TTJ 354 (Pune)
- *M/s Sony India (P) Limited vs. DCIT* 114 ITD 448 (Delhi)
- *DCIT vs. Indo American Jewellery Ltd* ITA No. 6194/Mum/2008
- *Agnity India Technologies Pvt. Ltd vs. Income-tax Officer* ITA No. 3856 (Del) / 2010
- *Philips Software Centre Private Limited* 26 SOT 226 (Bang)
- *ACIT vs. NIT* 10 Taxman.com 42
- *DHL Express India Pvt Ltd vs. ACIT* (2011) 11 Taxmann.com 40
- *Deloitte Consulting India Pvt Ltd vs. DCIT* ITA No.1084/Hyd/2010

(4) that the size as a criteria for selection of comparables is also recommended by OECD in its TP Guidelines, 2010. Para 3.43 of the Chapter on guidelines dealing with selecting or rejecting potential comparables, the OECD TP Guidelines enumerates the list of most commonly used quantitative criteria

– In para 15.4 of ICAI TP Guidance Note it has been observed that a transaction entered into by Rs 1,000 crore company cannot be compared with the transaction entered into by Rs 10 crore company. The two most obvious reasons are the size of the two companies and the relative economies of scale under which they operate.

(5) that the TPO's range of Rs. 1 crore had resulted in selection of companies like Infosys which is 375 times - turnover of Rs. 9,028 crores against Rs. 24.07 crores of appellant's AE transactions - bigger than the appellant.

– that based on the above, an appropriate turnover range should have been applied in selecting comparable uncontrolled companies; that selection on basis of size may be made based on Dun and Bradstreet's analysis, the classification of the software companies of which is:

> "The IT industry has been logically divided into 3 categories based on the net sales turnover.
>
> Large size firms (> Rs 20,000 mn)
>
> Medium size firms (Rs 2,000 – 20,000 mn)
>
> Small size firms (< Rs 2,000 mn)"

The assessee submits that above extract forms part of TPO's own order passed u/s 92CA. Accordingly, a turnover range of Rs. 1 crore at the lower end and Rs. 200 crores at the higher end may be adopted while choosing the comparables.

In the alternative, a selection on the basis of size may be made based on the NASSCOM categorisation. NASSCOM recognises three categories based on turnover:

> Tier I: Greater than USD 1 billion (approx Rs. 5,000 crores)
>
> Tier II: between USD 100 million to USD 1 billion (Rs. 500 crores to Rs. 5,000 crores)
>
> Others: less than USD 100 million (Rs. 500 crores)

With regard to use of Information received in pursuance to notice u/s 133(6)

For the comparability analysis, the TPO conducted enquiries from certain companies by exercising powers conferred by law u/s 133(6) of the Act. The appellant was provided these notices and replies received in a CD. The TPO proposed to accept/ reject these companies as comparables based on the responses received from these companies. In case of variance between reply u/s 133(6) and annual report, reply u/s 133(6) was given preference. The appellant submits that process adopted for issue of notice and use of such information is inappropriate for the following reasons.

<u>Arbitrary selection of companies for issue of notice</u>

From the details provided, it appears that in all 154 companies were issued notices and how these companies were selected was not clear as the basis of selection of these companies for issuance of notice u/s 133(6) was not provided and that the entire process lacks in transparency and fairness. It was also not clear as to whether all the responses have been incorporated in the CD provided? The whole procedure appears to be a selective exercise which was clear from the fact that six companies did not even find place in the initial list of companies generated by the TPO.

– that from the details provided along with the initial show cause notice, Megasoft Limited was rejected as a comparable on the ground that it fails RPT filter and employee cost filter. The TPO had stated that a company was not issued notice u/s 133(6), if it fails RPT filter. In case of Megasoft, a notice was nevertheless issued. What prompted the issue of notice was not spelt out. The appellant submits that the approach of TPO in issuing notices is arbitrary as also selective and hence faulty.

– that these issues have been raised before the DRP also. The DRP has stated that not giving of all the information is intentional. The DRP had stated that what was relevant only is given. The DRP's order is, therefore, bad in law and liable to be quashed.

The assessee had detailed the process adopted by it in the selection of comparables. The TPO also, in its initial show cause notice, has detailed the process adopted. However, in detailing the process of how the powers u/s 133(6) have been exercised and the disclosure of information obtained there-under, he was being secretive. It is said that only relevant information was provided. The assessee demanded a disclosure of the entire process as also the furnishing of all the replies. This has not been done. Withholding such information results in prejudice to the assessee and is against principles of natural justice.

<u>Authenticity of the Information received</u>

Rule 10D (3) provides that information specified in sub-rule (1) shall be supported by authentic documents. The TPO had not established whether the information obtained by way of notice u/s 133(6) was authentic and complete. In spite of these differences, the TPO had relied and completed the assessment based on replies received u/s 133(6), in preference to Annual Report of the companies which were audited by professionally qualified CA and approved by Board of Directors and that such reliance is bad in law.

The TPO had relied on segmental information received u/s 133(6), which did not form part of Annual Report. The bifurcation and reporting of income and expense into different segments as done by the company, was not audited by a CA. It was possible that the same may not be as per Accounting Standard 17 issued by the Institute of Chartered Accountants

of India and, hence, either incomplete or unreliable apart from being unverifiable.

Sankhya Infotech for e.g. was selected as comparable in preceding AY on the ground that it was software development company. The decision was based on reply received u/s 133(6). For the year under consideration, Sankhya Infotech has been rejected on the ground that it was a software product company [again based on reply received u/s 133(6)]. This inconsistency indicates that the entire process was neither transparent nor fair.

<u>Information obtained by process of issuing notice u/s 133(6) was not available in public domain or at the time of Study by the appellant</u>

Rule 10D prescribes the document to be kept and maintained u/s 92D. Rule 10D (1), e, f, g, h, i, j deal with the process and the method to be adopted in making the comparability analysis. Sub-rule 4 of Rule 10D states that the information and documents specified under sub-rule (1) and (2) should as far as possible be contemporaneous.

As per Rule 10D, the information and documentation prescribed therein must be kept and maintained by the appellant latest by the prescribed date i.e. for AY 2006-07 by 31-10-2006. The appellant has kept and maintained the information and documents required under Rule 10D accordingly.

The TPO was collecting and compiling data two/three years after the date of the appellant's documentation. This was impermissible. There was no finding that a particular company has been rejected or ignored as comparable although the data was available in the public domain by the specified date. It was not alleged that the data in existence by the specified date and adopted was incorrect. In choosing the most appropriate method the availability of data was a relevant factor (Rule 10C(2)(c)). The power u/s 133(6) is no doubt exercisable by the TPO. This power is however to be exercised to check and confirm the veracity of data used and adopted by a company. The power is not to be used to gather information that comes into public domain after the specified date.

S. 92CA (3), outlines circumstances on the basis of which the ALP computed by the company may be discarded and re-determined by the AO. Similar powers are available to the TPO. To invoke the powers u/s 92C(3), however, the material or document or information must be that which was in existence by the specified date. Otherwise, what was correct and complete on the basis of data existing by the specified date could become unreliable or incomplete in the light of data that comes into existence subsequently. Such a process or result is not contemplated. The powers u/s 133(6) is not to be used for gathering data not in existence in public domain by the specified date. The power u/s 133(6) is to be used for validating data that has been adopted. The

power u/s 133(6) cannot be used to obtain information to enable selection of comparables. That the data has to be in existence by the specified date is also recognised by the amendment made to the definition of 'specified date' - 30th November. It has been clarified that the date has been extended as sufficient data was not available under the existing specified date to make the comparison meaningful. The extension of the specified date is recognition as also an acceptance by the Legislature that the comparability analysis as also the determination of ALP has to be on the basis of data that is available in the public domain by the specified date. If subsequent information is permitted to be used, then the ALP would remain fluid. The assessee may determine ALP on the basis of a particular date. The TPO may re-determine ALP on the basis of data up-to another particular date. The DRP/ CIT(A) may re-determine ALP on the basis of updated information. The ITAT may improve the process further. This can lead to an ever changing ALP. The ALP is not a dynamic or fluid subject to vagaries of future. It is on the other hand a figure to be arrived at on the basis of data existing by the specified data.

The assessee cannot be expected to adopt data that was not in existence by the specified date. It is such data that should be validated by the TPO when a reference is made to him u/s 92CA.

The assessee submits that the data as available to it may be used for determination of the ALP. Data available subsequently or obtained through notice u/s 133(6) (which data is otherwise not available in the public domain) should be rejected and, thus, the approach adopted by learned TPO is bad in law.

Without prejudice that even adopting the subsequent data as used by the TPO, the assessee's margin satisfy the arm's length range if the following submissions are considered.

ALP COMPUTATION – IF THE ABOVE COMPANIES ARE EXCLUDED FROM COMPARABILITY

Based on all the above, the assessee has tabulated below, a list of comparables out of the TPO's comparables. Two tables have been prepared. The first table comprises of all companies falling within a turnover range of Rs. 1 crore to Rs. 200 crore (Dun & Bradstreet Analysis). The operating margins before and after working capital adjustment are detailed. The margins that remain after excluding companies that do not deserve to remain as comparables for the reasons already detailed are also mentioned in the notes to the table.

In second table, a similar exercise is carried out by adopting a turnover range of Rs. 1 crore to Rs. 500 crores (NASSCOM analysis).

TABLE 1 – TURNOVER RANGE 1 TO 200 CRORES

Sl. No.	Name of the Company	Operating Revenues	Operating Margin on Cost	WC Adjusted Operating Margin on Cost
1	Aztec Software Limited	1,28,61,36,000	18.09%	18.61%
2	Geometric Software Limited(seg)	98,59,57,838	6.70%	5.62%
3	KALS Information Systems Limited	1,96,90,390	39.75%	41.21%
4	R Systems International Limited(seg)	79,41,94,053	22.20%	20.21%
5	Tata Elxsi Ltd(Seg.)	1,88,81,25,000	27.65%	27.56%
6	Lucid Software Limited	1,01,91,181	8.92%	5.36%
7	Media Soft Solutions Private Limited	1,75,77,145	6.29%	4.10%
8	R S Software (India) Limited	915,707,164	15.69%	15.16%
9	SIP Technologies & Exports Limited	6,53,44,634	3.06%	1.00%
10	Bodhtree Consulting Ltd	5,31,89,165	15.99%	14.85%
11	Accel Transmatics Ltd(seg)	8,02,05,000	44.07%	42.23%
12	Synfosys Business Solutions Ltd	4,48,86,725	10.61%	7.27%
13	Megasoft Ltd	19,21,85,451	16.97%	10.53%
14	Lanco Global Solutions Ltd	35,62,93,560	5.27%	4.78%
	Arithmetic Mean		17.23%	15.61%
NOTES				
After removing KALS - Mean - 15.50% & WC adjusted mean 13.64%				
After removing KALS and Tata Elxsi - Mean - 14.49% & WC adjusted mean 12.48%				
After removing KALS, Tata Elxsi & Accel - Mean - 11.80% & WC adjusted mean 9.77%				

TABLE 2 – TURNOVER RANGE 1 TO 500 CRORES

Sl. No.	Name of the Company	Operating Revenues	Operating Margin on Cost	WC Adjusted Operating Margin on Cost
1	Aztec Software Limited	1,28,61,36,000	18.09%	18.61%
2	Geometric Software Limited(seg)	98,59,57,838	6.70%	5.62%

3	KALS Information Systems Limited	1,96,90,390	39.75%	41.21%
4	Mindtree Consulting Limited	4,48,79,82,158	14.67%	13.34%
5	Persistent Systems Limited	2,09,17,76,542	24.67%	23.79%
6	R Systems International Limited(seg)	79,41,94,053	22.20%	20.21%
7	Sasken Communication Technologies Limited(seg)	2,40,03,42,000	13.90%	13.14%
8	Tata Elxsi Ltd(Seg.)	1,88,81,25,000	27.65%	27.56%
9	Lucid Software Limited	1,01,91,181	8.92%	5.36%
10	Media Soft Solutions Private Limited	1,75,77,145	6.29%	4.10%
11	R S Software (India) Limited	91,57,07,164	15.69%	15.16%
12	SIP Technologies & Exports Limited	6,53,44,634	3.06%	1.00%
13	Bodhtree Consulting Ltd	5,31,89,165	15.99%	14.85%
14	Accel Transmatics Ltd(seg)	8,02,05,000	44.07%	42.23%
15	Synfosys Business Solutions Ltd	4,48,86,725	10.61%	7.27%
16	Megasoft Ltd	19,21,85,451	16.97%	10.53%
17	Lanco Global Solutions Ltd	35,62,93,560	5.27%	4.78%
Arithmetic Mean			17.32%	15.81%
NOTES				
After removing KALS - Mean - 15.92% & WC adjusted mean 14.22%				
After removing KALS and Tata Elxsi - Mean – 15.14% & WC adjusted mean 13.33%				
After removing KALS, Tata Elxsi & Accel - Mean - 13.07% & WC adjusted mean 11.27%				

Computation of Margins of the Appellant

The appellant's margins are tabulated below:

Particulars	*Amount in INR*
Operating Revenues	*24,06,82,087*
Operating Expenses	*21,67,21,274*
Net Profit	*2,39,60,813*
Operating profit/Operating cost	*11.05%*

The margin of the appellant as above is more than the arithmetic mean of comparables under Table 1 (Turnover range of Rs. 1 crore to Rs. 200 crore), after eliminating KALS, Tata Elxsi and Accel is within the 5% range.

The differential between the margins of the appellant as above and of the comparables under the Tables 2 above (Turnover range of Rs. 1 crore to Rs. 500 crore), after eliminating KALS, Tata Elxsi and Accel are within the 5% range. Applying, the ratio of Circular No 12 of 2001, which has been statutorily thereafter incorporated in the proviso to section 92C (2), no adjustment is required to be made to the reported values of the appellant's transactions with its associated enterprises.

Based on all the above, the appellant submits that its international transactions relating to software development services are at arm's length and addition made by the TPO and sustained by the DRP in this regard need to be deleted.

Based on all the above, the appellant has tabulated below, a list of comparables out of the TPO's comparables without applying turnover filter and rejecting the comparables for reasons already detailed and after considering the margins of the Megasoft at the segment level.

TABLE 3 – WITHOUT TURNOVER FILTER AND REJECTING COMPARABLES AS DETAILED ABOVE

Sl.No.	Name of the Company	Operating Revenues	Operating Margin on Cost	Adjusted Operating Margin on Cost
1	Aztec Software Limited	1,286,136,000	18.09%	18.61%
2	Geometric Software Limited(seg)	985,957,838	6.70%	5.62%
3	iGate Global Solutions LLtd (Seg.)	5,279,075,000	15.61%	13.57%
4	Persistent Systems Limited	2,091,776,542	24.67%	23.79%
5	R Systems International Limited(seg)	794,194,053	22.20%	20.21%
6	Sasken Communication Technologies Limited(seg)	2,400,342,000	13.90%	13.14%
7	Lucid Software Limited	10,191,181	8.92%	5.36%
8	Media Soft Solutions Private Limited	17,577,145	6.29%	4.10%
9	R S Software (India) Limited	915,707,164	15.69%	15.16%

10	*SIP Technologies & Exports Limited*	*65,344,634*	*3.06%*	*1.00%*
11	*Bodhtree Consulting Ltd*	*53,189,165*	*15.99%*	*14.85%*
12	*Synfosys Business Solutions Ltd*	*44,886,725*	*10.61%*	*7.27%*
13	*Megasoft Ltd*	*192,185,451*	*16.97%*	*10.53%*
14	*Lanco Global Solutions Ltd*	*356,293,560*	*5.27%*	*4.78%*
15	*Flextronics Software Systems Ltd*	*5,951,198,183*	*27.24%*	*26.78%*
	Arithmetic Mean		*14.08%*	*12.32%*

The differential between the margins of the appellant as above and of the comparables under the Tables above, after eliminating KALS, Tata Elxsi, Accel, Infosys Technologies and Mindtree is within the 5% range. Appling, the ratio of Circular No 12 of 2001, which has been statutorily thereafter incorporated in the proviso to section 92C(2), no adjustment is required to be made to the reported values of the appellant's transactions with its associated enterprises.

Based on all the above, the appellant submits that its transactions under software development segment are at arm's length and addition made by the TPO and sustained by the DRP in this regard need to be deleted.

Benefit of 5 percent range:

Assuming without admitting that a TP adjustment is to be made, the appellant submits that it should be given a standard deduction of 5% as provided under proviso to section 92C(2) before making adjustments for the transfer price.

The appellant submits that its above contention is supported by the following judicial precedents:

- *M/s Sap Labs India Private Limited vs. ACIT* 2010-TII-44-ITAT-BANG-TP
- *Philips Software Centre Pvt Ltd* 26 SOT 226
- *MSS India Private Limited* 32 SOT 132
- *Customer Services India (P) Ltd vs. ACIT* 30 SOT 486
- *Skoda Auto India Pvt Limited vs. ACIT* 2009-TIOL-214-ITAT-PUNE
- *Development Consultants P Limited vs. DCIT* 23 SOT 455
- *Sony India P. Ltd.* 315 ITR 150
- *Cummins India Limited vs. DCIT* ITA No. 277 & 1412/PN/07
- *TNT India Pvt. Ltd. vs. ACIT* 10 Taxmann.com 161

- *Abhishek Auto Industries Ltd vs. DCIT* 2010-TII-54-ITAT-DEL-TP
- *Technimont ICB Pvt Ltd vs. ACIT* 2011-TII-31-ITAT-MUM-TP

5.1. In conclusion, it was averred that even after adopting the comparables as chosen by the TPO subject to rejection of some companies for justifiable reasons, the margins of the appellant are within the arm's length range of the adjusted ALP. These margins would skew more favourably, if comparables of the appellant that deserve to be adopted are considered. In view of the favourable conclusion on facts, detailed arguments or submissions have not been made on legal issues likes (i) the reference to TPO being bad in law; (ii) the CIT's approval for reference to TPO also being bad in law; and (iii) the additions being unsustainable as the definition of income or the computation process under section 28 to 44 not envisaging a reference to or incorporation of an adjustment proposed under Chapter X.

DEDUCTION UNDER SECTION 10A

While computing deduction u/s 10A, the AO reduced Rs. 527,929 from the export turnover. However the same has not been reduced from the total turnover. In this regard, the appellant submits that what is reduced from export turnover should also be reduced from total turnover. The appellant's contention is supported by the Special Bench decision in the case of *ITO vs.ak Soft* (2009) 313 ITR (AT) 353 and plethora of decisions listed on pages 373 to 375 of PB-I. The appellant submits that amount reduced from export turnover should also be reduced from total turnover.

6. On the other hand, the Ld. D.R came up with a spirited refutation of the Ld. A R's contentions. The learned DR also filed written submissions, essences of which are summarized, chronologically, as under:

(1) During the proceedings u/s 144C of the Act, the DRP had given opportunities twice to the assessee.

Relies on the case laws:

(a) *Messe Dusseldorf vs. DCIT* (2010) 320 ITR 565 (Del)

(b) *Intimate Fashion (India) (P) Ltd vs. JCIT* (2010) 321 ITR 265 (Mad).

With regard to procedure:

Ground No.2

The DRP after going through various submissions made by the assessee and also after considering various judicial pronouncements on the issue such as the decision of the special bench of Hon'ble ITAT in the case of *M/s. Aztec Software and Technology Services Ltd vs. ACIT* reported in 107 ITD 141 (SB) (Bang) and Hon'ble High Court of Delhi in

the case of *Sony India Pvt. Ltd vs. CBDT* reported in 288 ITR 52 and various other decisions held that there was no illegality or arbitration in the order of the Assessing Officer in making a reference to the TPO or in adopting the computation of 'ALP' determined by the TPO.

Further placed reliance on the judicial pronouncement on this issue as follows:–

- *Morgan Stanley & co.*(2006) 284 ITR 260, (AAR)
- *Sony India (P) Ltd vs. CBDT* (2006), 288 ITR 52 (Delhi),
- *Ranbaxy Laboratories Ltd. vs. Addl. CIT* (2008) 299 ITR 175 (Delhi)
- *M/s. TNT India Pvt. Ltd vs. ACIT* ITA No. 1442/Bang/08
- *M/s. SAP LABS India Pvt. Ltd vs. ACIT* ITA No398/Bang/2008
- *M/s. Deloitte Consulting India Pvt. Ltd vs. DCIT* ITA No 1084/Hyd/2010
- *M/s. Tally Solutions Pvt. Ltd./ vs. DCIT* ITA No 1235/bang/2010

These objections of the assessee with reference to the procedure are covered against the assessee by the decisions referred supra and, hence, there is no merit on the grounds and liable to be rejected.

<u>Ground Nos. 3 & 4</u>

These grounds relate to administrative matters and the DRP constituted by the CBDT by specific notification and, hence, validly constituted as per provisions of Act. Moreover, appeal in ground nos. 3 and 4 are not emanating from the order of the TPO and the DRP; hence not maintainable.

<u>Ground No. 5 Relating to Charge of Income-tax</u>

That s. 92(1) of Chapter X clearly provides the procedure for computation of income arising from an international transaction. S. 92(1), says that "Any income arising from an international transaction shall be computed having regard to the arm's length price."

The term international transaction has been defined in s. 92B and the procedure for determining arm's length price in relation to an international transaction has been provided in s. 92C. Therefore, there remains no doubt that the adjustments have to be made to the income on the basis of arms length price determined, and, therefore, while computing the income of the assessee the provisions of Ch. X are clearly applicable.

<u>Ground No.6</u>

In regard to the issue of notices u/s 133(6), it was stated that the TPO discussed in detail in para 14.5 to 14.5.1, which reveals that copies of notices u/s 133(6) issued to the companies as well as the

copies of the replies received from companies were in fact given to the assessee in a soft copy for its comments. The decision of the TPO based on information collected was also duly communicated to the assessee. The DRP have upheld the AO's action and after considering the assessee's objection and held that TPO is empowered to collect the details relevant to the transfer pricing proceedings and the TPO used his power to collect relevant information requiring for better comparability analysis. The TPO used the data for information that was available to him in the public domain whenever a company did not submit the information or wherever the notice u/s 133(6) not served at the latest address available even after repeated attempts. The TP order transpires that the assessee had furnished its reply vide letter dated 21-09-2009 and no issue was raised in regard to the cross-examination of the concerned parties which dispel the assessee's contention that it was not given opportunity to cross-examine the parties involved . In this connection, the Revenue relies on the pronouncements of the Hon'ble ITAT Bangalore in the case of *M/s. Genesis Integrating System (India) Pvt. Ltd vs. DCIT* in ITA No/231/(Bang)/2010 and by the Mumbai Tribunal in *M/s. Symantec Software Solution vs. ACIT* in ITA No 7894/Mum/2010.

From the facts as well as legal position discussed above, the TPO's action would be according to the statutory provision of the Act and notices U/s 133(6) were validly issued

Section 92CA(3) empower the TPO to consider such evidence as he may require on any specified point and after taking into account all relevant materials which he has gathered, he shall determine the ALP in relation to the international transaction in accordance with the provisions of s. 92C. Thus, if the information as gathered by the TPO is relevant material for the purpose of determining the ALP in relation to the international transaction then it was not wrong in using the updated data.

<u>Ground Nos.7 & 11</u>

The assessee selected comparables out of which the ITO accepted 7 comparables. Filter matrix adopted by the TPO has discussed in para – 11.1 based on the filter criteria the TPO discussed each comparable from page No 62 to 72 and eliminated 42 comparables. The DRP also discussed this issue elaborately.

It is relevant to mention the ruling of the Hon'ble ITAT, Mumbai in *ACIT vs. M/s Maersk Global Services Centre (India) Pvt. Ltd.* ITA No 3774/Mum/2011.

In the instant case, since the TPO has excluded comparables chosen by the assessee which can be seen in the order u/s 92CA of the Act cited.

<u>TURN OVER FILTER</u>

The assessee had contended that TNMM method followed by the TPO, adopting a turn over filters of Rs. 1 crore on the lower end and infinity on the higher side is wrong. The assessee submitted new study order TNMM adopting turn over range of Rs. 1 crore at the lower end and Rs. 200 crores at the higher end while choosing the comparables is based on Dan & Bradstreet analysis of classification of software companies. Further, the assessee had provided fresh comparables having a turnover filter range of Rs. 1 c rore to 500 crores based on Nasscom categorisation.

It was submitted by the learned DR that the ICAI TP Guideline note and NASSCOM categorisation are only certain opinion formed by the agencies and general in nature. Against the assessee's argument, it was submitted that the TPO in his order stated that the tax payer's argument of size, scale and nature of operation was also raised during the proceeding U/s 92CA of the Act and the same has been dealt with in detail in the order (in para 9.2). Further it also held that lesser known companies like Mega Soft Ltd, Accel Transmatic Ltd, KALS Info Systems Ltd etc are having almost the profit margin equivalent to the margin of Infosys Technology Ltd. which means that brand per se does not effect the margins. Thus brand name may get higher turnover but it does not necessarily mean that it would generate higher margin. It was stated that the observation of the TPO has also supported by the decision of Hon'ble ITAT, Mumbai 'E' Bench in u/s *Symantec software solutions private Limited vs. ACIT* in ITA No 7894/MUM/2010.

<u>Submission of learned DR relating to use of information received in pursuance to notice u/s133 (6).</u>

For the comparability analysis, the TPO conducted enquiries from certain companies by exercising power conferred by law u/s 133(6) of the Act. The assessee was provided these notices and replies received in a CD. The TPO proposed to accept/reject these companies as comparable based on the response received from these companies. It was urged that this issue has already been discussed in ground no 6. Hence not deem fit for further comments for sake of repetition.

<u>Submission on the margin or adoption of various companies as comparable:</u>

The A.R. of the assessee urged that the following companies may be excluded as comparable in view of the unusual features:–

	Company Name	OP to Total Cost
i)	Ms/. Megasoft Ltd	52.74
ii)	M/s. KALS Information System Limited	39.75
iii)	M/s. TATA Elexi Limited	27.65
iv)	M/s. Accel Transmatic Limited	44.07

v)	M/s. Mind Tree Consulting Private Limited	14.67
vi)	M/s. Infosys Technologies Limited	40.38

The A.R. of the assessee pointed out several deficiencies in adopting these companies as comparable, hence it is appropriate to offer comments company wise in following paragraphs:–

i) <u>MEGASOFT LTD</u>

It was contended by the Revenue that while considering reference petition in the case of *M/s Yadlee Infotech Pvt. Ltd.* The DRP held that –

> Sub-section (7) of section 92CA has empowered the TPO to exercise all or any of the powers mentioned in section 131 or sub-section (6) of section 133 for determination of ALP. The object is clearly to enable the TPO to seek clarifications where there is ambiguity or insufficiency or obfuscation of data or information in public domain so that the ALP can be arrived at in a more precise manner. As long as the TPO has acted objectively, fairly and without any bias, the assessee cannot have any grievance on the issue. As far as use of M/s Megasoft Ltd as a comparable is concerned, any lacuna on the part of the TPO to giving of opportunity to the assessee before including the company as a comparable gets cured by the DRP taking into consideration assessee's objections in the matter.

The DRP discussed comparability in regard to M/s Megasoft Ltd and this is common in both the case, hence the DRP's findings are equally applicable in the instant case.

Further, it was submitted that:

M/s Megasoft has furnished segmental information in pursuance to the notice issued u/s 133(6) which is given below:

Financial statement for year ending 31-03-2006 operating Revenue (excluding non operating Revenue) are:

Particulars	Blue ally(consulting Division) in Rs.	XIUS-Bcits Division (product Division) in Rs.	Total in Rs.
Sale/service Export	17,07,45,151	24,32,21,163	41,39,66,314
Domestic	2,14,40,300	12,60,56,269	14,74,96,569
Total	19,21,85,451	36,92,77,432	56,14,62,883
As per TPO			56,14,62,883
Expenditures			
Personnel Cost	9,66,62,247	9,11,68,236	18,78,30,483

Increase/Decrease in work- in-progress	98,62,642	49,62,180	1,48,24,822
Operating Expenses (excluding net loss on foreign exchange , loss on sale of assets, finance changes and provision made on debtors)	4,18,62,533	9,61,41,392	13,80,03,925
Depreciation	1,59,14,244	1,68,55,710	3,27,69,954
Total	16,43,01,666	20,91,27,519	37,34,29,185
As per TPO			36,75,94,111
Profit Before Tax	2,78,83,785	16,01,49,913	18,80,33,698

It is also clarified by the company that:

1) Blue ally division is an offshore and on limit consulting division and does jobs based on customers requirements and billing done on hourly basis.
2) XIUS-BCCIL is a product which caters the need of mobile software industries. This product is not readymade to the industry. It has to be customise to the requirement of each customer and pricing will be done accordingly.

The TPO in para 11 of the order and stated that a software development process is a structure imposed on the development of a software product. Synonyms include software life cycle and software process. These are several modes for such process even describing approaches to a variety or activities that take place during the process. In furtherance he also differential software development process or lifecycle.

a) Software product company
b) Software development company
c) Software customisable company
d) Software trading company

As regard to software customisation company buys software products in the form of license from third parties or uses its own software products for customisation to suit the requirements of the customer. In this case only right to use the software is passed on to the customers. But these may be companies which does only customisation based on the software products bought directly by the customers. In such situation customization includes coding which in a way are a kin to software development service providers. Thus if a company is only into pure customisation, the same is also considered as a software development service providers.

M/s Megasoft limited vide letter dated 19-04-2010 clarified that XIUS-BCGI (product division) is a product which caters the needs of mobile software industries. This product is not ready made to the industry. It has to be customised to the requirement of each customer and

pricing has been done accordingly. It indicate that company products are in the form of license from third parties and customised as per requirement of its customers, under these circumstances M/s Megasoft Limited as a service provider akin to software development services.

The A.R of the assessee stated that company has made extraordinary or supernormal profit of Rs. 34,62,63,000/- This figures nowhere appears in the financial statement furnished in the company. In fact operating profit of the comparable company is Rs. 18,80,33,698. Arm's length price is the basic foundations for determinations of income from international transactional. It is provided that any income arising from an international transaction would be determined by adopting the arm's length price as the basis disregarding transfer price recorded by the eternises concerned. The AR of the assessee stated that M/s Megasoft limited owns intellectual property right and patents is however how far these influenced the International Transactions, no explanation has been furnished.

Further it is also stated that company hold opening invention of Rs. 3,20,26,000/- as on 31-12-2005 however no such figures appears at page 212 of the assessee's paper books. It is pertinent to note that in the annual report it is mentioned that (please refer column 12, page 215 of the assessee's paper book)

Quantitative details:

The company is in the business of development and maintenance of computer software. The development and sale of such software cannot be expressed in any generic unit. Hence it is not possible to furnish the quantitative details and the information required under paragraphs 3, 4 C and 4D of part II of schedule VI to the companies Act 1956.

Consumption particulars are given below:

Particulars	Year ended 31 Dec 2006 Rs. 000	Year ended 31 Dec 2005 Rs. 000
Computers and allied peripherals used for system integrations	51,259	64,821

From it reveals that the company is basically in the business of software development services. The facts stated above the TPO as well as the DRP has rightly computed operating profit margin considering both division i.e. consultancy division and product division. Thus the company satisfies the filter criteria adopted by the TPO hence cannot be rejected merely because extra ordinary or super normal profits, hence same may be retained as comparable.

ii) **KALS Info system limited.**

The TPO held that the company engaged in software development services. The software products constitute only 0.33% of its revenue and

other income constitute only 0.7% of its revenue. Thus the revenues from software development services constitute almost 99% of the total operating revenues and it qualifies 75% revenues filter from software development, accordingly considered as comparable.

At the time of appeal hearing, the assessee's AR submitted written argument and in conclusion, it was urged that the company be not adopted as a comparable. In the alternative, an opportunity to cross examine the said company or authorised person was sought to test the information/data submitted.

The TPO and DRP have, however, considered this company as a comparables adopting the figures supplied in the reply to notice under section 133(6). In the reply to notice u/s 133(6), the company has contended that it is a pure software development company by stating that: (refer page 67 of the TP order):

> "The core of our business may be classified as that of Pure Software Development Service Provider."

The above is contrary to the factual information as available in the annual report of the company. In view of all the above, this company is not to be adopted as a comparable. Even otherwise, the opportunity of cross examination as requested was not granted.

However, it was the stand of the Revenue that on a perusal of the financial statement of KALS for year ending 31-03-2006, from it reveals that export receipt and other receipts disclosed as below:

	Rs.	
Application Software	1,93,29,198	97.54%
Other Receipts	3,61,192	1.82%
Training	1,25,949	.64%
Total	1,98,16,339	100%

Thus operating revenue consist software application, other receipts and training, same also appears in segmental information (please refer col-9 of notes on account). Further it also observed that auditors has not given quantitative details and corresponding amount in regard to purchase, production and sale of software products made during the year which requires as per part II of schedule VI to companies Act 1956. This clearly indicates that major revenue consist software development services. The auditor put remarks that "The Company is engaged in development of software and software products since its inception." This is general remarks put by the auditors in fact revenue for the year order consideration mainly from software development segment which constitute 97.54% of the total income . The A.R stated that the total turnover of KAL is Rs. 2.15 crores, and holds an inventory of Rs. 1.27 crores, however from the statement of account for year ending 31-03-2006 nowhere appears such figures(inventories the amount of Rs. 1.27 crores

actually represents receivables. Debtors arising on rendering of software development services for evidence enclosed copy of statement of account as per annexure 'A'.

Thus, the assessee was giving misleading facts. In view of the facts discussed above, the TPO has rightly considered that the company is a software development service provider and there is no merit in the assessee's contentions. The company's its letter dated 13-01-2009 clearly mentioned that "The core of our business may be classified as that of pure software development service provider" Thus company itself confirming being a software development service provider as such there is no question of major revenue from software products.

iii) TATA ELXSI LIMITED:

The TPO has order held that the TPO did not consider verticals or horizontals within the software industry. The turnover limit of the 100 crore is not accepted by the TPO and the functional difference has considered only the software development and service segment of the company, the RPT of the company is Rs. 8.39 crores and the segmental revenue of the company is 188.81 crores which constitute 4.4% of the sales. According to the TPO, the aforesaid company satisfies all the filters hence included as a comparable.

In written submission the assessee's AR concluded that:

> *"Hence even to judge our own performance we do not have a comparable company which is operating in all the areas we operate. Considering these facts, we feel it is not fair to use our financial numbers even to broadly compare the performance of any other company who we feel are not in any one of the complex segments we are operating". Despite such "warning" from the company, the same has been adopted as a comparable withou t rebutting the "warning" or conducting fresh investigation to disprove or discredit the limitation expressed.*
>
> *Further Tata Elxsi Limited does substantial research and development and owns substantial intangibles. This fact is highlighted in the extracts of annual report of the company. Based on all the above, it is submitted that this company should be rejected as comparable."*

Similar submission also made before the TPO and considered the assessee's objections. The TPO have also asked information by issue of notice u/s 133(6) of the Income Tax Act and in compliance, M/s Tata Elxsi Limited clarified that product development services mainly develops software for customers who look for solution through embedded software.

Innovations design engineering provides products, design and engineering for automotive consumer goods and electronics enclosures. It delivers concept of now products though computers models, using a team

of highly specialised industrial designers and graphics specialists and generals 3D CAD models and specification for products.

Visual computing labs order takes contests development and animation services using commercial and proprietary high end software for graphics, animation and image/video editing content or edit existing content to add special effects as specified by customers, using very high end computers and software.

As per financial statement segmental revenues disclosed as under:

Particulars	System integration and support (Rs. 000)	Software development and services(Rs. 000)
Revenues	4,733.42	18,882.42
Identifiable operating expenses	4,032.86	14,835.21
Segmental opening income	700.56	4,047.21

M/s Tata Elxsi Limited furnished the segmental revenue i.e. software development services for F.Y. 2005-06 as under:–

	Rs.
Sales	18,881.25
Other income	1.17
Total	18,882.42
Cost of sales	435.33
Personnel expenses	10,676.21
Administration expenses	3,058.91
Depreciation	620.43
Total	14,790.59
PBIT	4,091.53

PBIT after excluding exchange loss and interest.

Thus company has furnished segmental revenues and expenses. Merely because expenses from cash of the sub-activities are not available tantamount for rejection. In the directors report, company's operations are broadly classified into two business segments i.e. software development and services and systems integrations and support (please refer column 1 of director's report) and break up of both segment discussed above. Thus the assessee contention on this point is not tenable. Considering financial statements are segmental information furnished by M/s Tata Elxsi Limited and based on the same data, the TPO has computed operating profit on operating cost. In the light of facts stated above the TPO has rightly retained as a comparable.

iv) ACCEL TRANSMATIC LTD

Finding of the TPO is that the company has two divisions under the software services segment. The two divisions are (1) Ushus technologies dealing in software development concentrating on embedded software network system, imaging technology and outsourced product development and (2) Accel animation studios- software services for 2D/3D Animations, Special effects creation and Game Asset Development. Though the animation services are in the nature of IT enabled services, the fact is that the division did not start its operating during the F.Y 2005-06.

From the software segment qualifies the employee cost filter as the segmental employee cost is Rs. 268.05 lakhs on the segmental revenues of Rs. 802.05 lakhs i.e. 33.30% on revenues. Thus the software segment qualifies the employee cost filter as the same is applied on the segment and not on each of the undertaking which make include inter-transfer that might not be reflected in the above unit wise. Holding thus considered as comparable.

i) "The assessee in its written submission contended that:–

> 4.3. On careful perusal of the business activities of Accel Transmatic Ltd. DRP agreed with the assessee that the company was functionally different form the assessee company as it was engaged in the services in the form of ACCEL IT and ACCEL animation services for 2D and 3D animation and therefore directed the Assessing Officer to exclude ACCEL Transmatic Ltd., form the final list of comparables for the purpose of determining TNMM margin."

Based on the above, the appellant submits that Accel Transmatic Limited should be rejected as comparable.

To refute the assessee's contentions, the Revenue has contended that on verification of relevant details reveal that the financial statement for the year 31-03-2006.

Sales income-income from operation:-

	Rs.	Rs.
Manufacture sales	43,143,255	
Trading Sales	71,758,548	
Total		114,901,803
Service income		
Maintenance and repairs services	25,341,956	
Training and education services	6,302,823	
Software services		
Domestic	24,705,319	

Export	55,500,099	
Total		181,850,197
Grand Total		296,752,000

M/s Accel Transmatic Ltd vide its letter dated 27-01-2009 clarified in regard to Ushus technologies that (kindly refer para 4 page 75 of paper book).

"Ushus Technologies is the technology division of M/s. Accel Transmatic Ltd that produces custom software development services to companies' world wide. Ushus technologies division services clients in offshore software development and on site consultancy"

From a clarification, it reveals that given by M/s.Accel Ushus Technologies division of Accel is exclusively software service division.

Further it is also contended that the IP Rights have been created/ developed by Ushus Technologies division and related cost of creation and transfer of IP Rights has also been recorded in this segment. In this context it is to be mentioned that the Accel is deriving revenues from manufacturing sales, trading sales and software development services, details of income each division is given above. Under schedule 16-B given the cost of sales of traded goods on which the cost of IP rights also embedded. It used to receive royalty/on sale of software licenses not for the software services rendered to the off shore/on shore clients.

The A.R of the assessee submitted that out of service income to the tune of Rs. 18,18,50,157 rendered services to related parties amounting to Rs. 5,62,74,970, which constitutes 31% of the total services revenues. However as per statement account shows service income includes:

	Rs.
Maintenance and repairs services	25,341,956
Training and education services	76,302,823
Software services	80,205,618
Total	181,850,397

As per the schedule 'F' (page 73 of paper book) transaction with related parties would be Rs.5,62,74,970 shown against "Rendering of services" however there is no information appears towards software development services. Even though company has given segmental information (kindly refer column-20.15, based on these information, the TPO considered as comparable.

The fact discussed above Accel has rightly been retained as a comparable.

v) <u>M/S MINDTREE CONSULTING LIMITED</u>

The TPO has selected as a comparable since the company engaged in software development services and qualifies all the filters applied by her. As

per final list of TPO's comparable M/s Megasoft having a turn over Just Rs. 56 crores and profit margin of 52.74%. Similarly M/s I Gate Global Solution Ltd having a turnover of Rs. 527 crores and profit margin only 15.61% even M/s Mindtree consulting Ltd. Having turnover of Rs. 448 crores has a profit margin only 14.67%, thus the TPO held that there is no relationship between margin and turnover and, hence considered as a comparable.

In written argument the assessee stated that:–

> "As per the notes the Account (extract in page 87 of PB-II) Mindtree has entered into an agreement with the customers in December 2003 where by the warrant have been issued to the customer. The warrant can be converted into equity shares at an exercise price of Rs. 2 per share. A total of 8,266,777 warrants had been issued under this agreement. The customer can convert these warrants into equity shares based on revenue generated by the customers during the defined period and on fulfilling the conditions specified in the agreement.
>
> The issue price of Mindtree share was fixed at Rs. 425 per share as on the listing dated 7th March 2007. This provides an incentive of Rs. 423 per share to the customer. This is an indirect benefit to the customers to the tune of Rs.349.68 crores equity.

From the notes to accounts year ending 31-03-2006 reveals that as per agreement 82,66,777 warrants has been issued to the customer and same can be converted into shares at an exercise price of Rs. 2 per share, however there is no details available conversion of shares during the year. Even though how it influenced/factorised the international transaction with its AE owing to issue of warrants and conversion of shares remained unexplained. No such arguments were made before the TPO nor the DRP. It is to be noted that the margin of the comparable company on international transaction is relevant and not the AEs revenue in remunerated by assessee. The income from international transaction is computed having regard to ALP and nothing else. Therefore the arguments advanced by the assessee that the above strategy effectively moved the marketing expenditure from the profit and loss account to the balance sheet and is totally irrelevant because ALP is a deemed price. The price is compared in the contest of margin profit of the assessee in relation to international transaction and not the share in the revenue of the AE. Thus what is relevant is the margin/profit of the assessee earned from international transaction and comparison with the uncontrolled transactions.

Hence there is no merit in this argument.

vi) INFOSYS TECHNOLOGIES LTD

While analysing the comparables the TPO observed that products revenue of the company for the F.Y. 2005-06 for Rs. 357 crores out of its operative revenues of Rs. 9028 crores i.e. 3.95% only to total operative

revenue, thus more than 96% of its revenues are from software development services and accordingly qualifies filter of 75% from software development services.

The TPO further held that margins of the lesser known companies like M/s Accel Transmatic Ltd. 44%, M/s. KALS Info System 39.75%, M/s Megasoft Ltd. 52.74% are having same or better margins than Infosys which means that brand or size per se does not affect the margins though brand name may set higher turnover but it does not necessarily generate higher margin. The margins does not automatically indicate that the company charged premium over market for the services rendered, however the assessee did not produced any evidence except making statement that it charges premium over market for its services. Holding thus the TPO retained this company as a comparable.

The AR of the assessee argued in writing and the same is reproduced below:

> *"Infosys Technologies Limited is 443 times bigger than the appellant and is thus significantly dissimilar in size. For the reasons already detailed, Infosys Technologies Limited should not be accepted as a comparable. The Delhi Tribunal decision in the case of Agnity India Technologies Pvt. Ltd vs. Income-tax Officer ITA No. 3856 (Del)/ 2010 has held that Infosys Technologies limited cannot be compared with small companies having nominal turnover and bearing minimal risks".*

Against the assessee's argument it was submitted that the observation of the TPO is that Infosys Technologies Limited engaged n software development services and brand name may get higher turnover but it does not necessarily would generate higher margin. The assessee has not demonstrated as to how the difference in turnover has influenced the result of the comparables it is accepted economic principle and commercial practice that highly competitive market condition one can survive and sustain only by keeping low margin but high turnover as held by the Hon'ble ITAT Mumbai "E" Bench in the case of *M/s Symantec Software Solution Pvt. Ltd vs. ACIT* (supra). Further, the assessee referring an article published in the Economic Times dated 12-01-2011 which show in general nature and no specific instance has been brought on record. Secondly article relates for the F.Y. 2010-11 where as transaction in question for F.Y. 2005-06 i.e. after five years and competitive market conditions also varies during the relevant period.

Thus, merely because profit margin is on the higher side cannot the reason for elimination as comparable; it is not the general rule to exclude the same unless specific fact has been added.

Relying on the judicial decision cited above the TPO has rightly chosen the comparable and the assessee argument in this regards deserves to be rejected, more so because the assessee itself considered as comparable

The AR of the assessee submitted list of 14 comparable, (Table-I) adopting turnover of Rs.1 Crore to Rs.500 crores based on NASSCOM and remaining comparable excluded on the please that turnover exceed Rs.500 crores as under:

Sl.No	Company Name	Sales (Rs. Crores)	OP to total cost%
1	Infosys Limited	9,028.00	40.38
2	Mindtree Consulting Ltd	448.79	14.67
3	Persistent systems Ltd	209.18	24.67
4	Sasken Communication	240.03	13.90
5	Flactronics Software System Limited	595.12	27.24
6	I Gate Global Solution Ltd (Seg	527.91	15.61

In this connection it is to be mentioned that comparable selected by the TPO is justified as discussed above and, hence, the assessee's plea for exclusion of comparable turnover basis is not justifiable.

Secondly operating profit to total cost computed by the assessee at 16.97% instead of 51.73 (as per DRP's direction) in respect of Megasoft Ltd. This point also discussed in the preceding paras, and, hence, the assessee's contention is objectionable. If margin of Megasoft be at 51.73% arithmetic mean as per

Table - 1 would be	19.71%
Table - 2 at	19.36% and as per
Table – 3 at	16.39%

Alternatively, the assessee listed 17 comparables based on turnover range Rs. 1 crore to 500 crores and in Table B 15 comparables after excluding KALS, Tata Elxsi, Accel, Infosys Technologies and Mindtree also not acceptable as discussed in preceding paragraphs.

Relies on the case laws:

i) *Exxon Mobil Company India Pvt. Ltd vs. DCIT* ITA No. 8311/mum/2010;

ii) *Symantec Software Solution Pvt. Ltd vs. ACIT* ITA No. 7894/mum/2010

As held by the Hon'ble ITAT, Mumbai in the case of Symantec Software Solution Pvt. Ltd (supra) that in the case of hand, the assessee raised objections only because some of the comparables are having profit and also high difference in the turnover and not because of high or low turnover has influenced the operating margin of the comparables. All the objectives and contentions raised by the assessee are discussed above and the TPO as well as the DRP were justified in retaining as comparables.

APPELLANT'S COMPATEBLES:–

In the written submission the assessee submitted that certain comparables proposed by the appellant have been rejected by the lower authorities. The proposed comparables are:–

1) *Goldstone Technologies Pvt. Ltd.*
2) *TVS Infotech Ltd.*
3) *VMF Soft tech Ltd.*
4) *Visu International Ltd.*
5) *Visual Soft Technologies Ltd.*
6) *VJIL Consulting Ltd.*

Further it is also submitted that comparables selected by the assessee have not been factored in the analysis shown in three tables and if the analysis under any of the three tables are modified incorporating the above comparables, the result would be increasingly skew in favour of the appellant.

In this connection it was submitted that these comparables were not listed in the TP study documents maintain by the assessee. Even proposal for inclusion for aforesaid comparables also was not made before the TPO. Thus, no such matters were before the TPO. The proposal of comparables were before the DRP first time (please refer page- 348 to 356 of paper book-1 of the assessee filed before the DRP) since the comparables selected by the assessee not before the TPO, except VMF Soft tech Limited (please refer page -141 of paper book-1 of the assessee). Furthermore no analysis has been given by the assessee to determine whether comparables qualifies filter criteria adopted by the TPO. Therefore the same cannot be accepted at this stage; hence the assessee's contentions on this point may be rejected.

i Gate Global Solution Limited:

The assessee had raised contentions in computing margin in the case of M/s. iGate Global Solution Limited. It was submitted that use of information which is not available in public domain and sourcing the same through private mean and labelling it as information under section 133(6) is bad in law. It was also submitted that:–

> *Further assuming without admitting that this segmental information can be used, the assessee submits that the same is incomplete and improper. In the segmental data on page 98 of the Order, the operating profit (before depreciation) of the company has been arrived at Rs. 53,93,57,000/-. This amount tallies with the operating profit before depreciation as reflected in the company's audited financial statements. After this an addition to expenses has been made for depreciation and reduction from expenses has been made for "extraordinary*

expenses". The adjustment for "extraordinary expenses" for software service segment is Rs. 56,86,28,000/-. What are these "extraordinary expenses" is not detailed. The amount of "extraordinary expenses" is 10.77% of revenues. However no details on the nature of expense or reasons for treating this as "extraordinary expenses" are forthcoming. Further, from the audited financial statements of iGate it is clear that it has not treated any expense as "extraordinary expenses". Possibly, iGate has during the course of its own TP assessment claimed these expenses "extraordinary expenses". The TPO has possibly taken those margins for comparability purposes without detailing the reasons for treating the expenses as "extraordinary expenses". Accordingly, the assessee submits that these expenses should be considered as normal operating expenses.

The revised operating margin of iGate would then be as follows:

Description	*Amount(Rs. In 000s)*
Operating Revenues	*5,279,075*
Expenses debited to P&L Account	*5,135,006*
Less: Non-operating items	*–*
Operating Expenses	*5,135,006*
Operating Profit	*144,069*
Op Margin	*2.81%*

The assessee submitted that the revised operating margin of 2.81% percent on cost as computed above be considered for comparability purpose.

In this connection it was mentioned that originally the assessee itself had chosen aforesaid company as a comparable, however while issuing show-cause the TPO had not considered as a comparable. After receiving the company's letter in compliance to the notice u/s 133(6), the TPO examined the data, it found acceptable as comparable. Therefore issue of notice under said section cannot be construed bad in law.

From the segmental information available on financial statement for F.Y. 2005-06 in respect of M/s. i Gate Global Solution Ltd, reveals that operating cost consist, salaries and wages, selling and marketing, depreciation etc totalling to Rs. 5,13,50,06,000 which includes certain extra ordinary item like payment of deferred ESOP compensation of Rs. 25.93 crores bad debts of Rs. 33.08 lakhs and also other miscellaneous expense which not relatable into the international transactions. The TPO has worked out extraordinary items after analysing the financial statement for the F.Y. 2005-06.

However, according to the assessee operating cost would be Rs. 5,13,50,06,000 (Rs. 4,56,63,78,000+5,68,628,000), resulting margin would be at 2.81%. Whereas TPO computed margin at 15.61% after considering

extra ordinary items of Rs. 56,86,28,000, increased operating profit (segmental) by Rs. 71,26,97,000. Here it is to be mentioned that either extra ordinary items to be included to the segmental profit or excluded from the segmental operating cost there is no difference so far as the margin of the comparable. The facts discussed above the TPO has rightly computed margin at 15.61%. The DRP had also held that margin in respect iGate Global Solution has correctly been worked out by the TPO. In view of the above facts there is no merit in the assessee objections and the same may be rejected.

Ground No.10

The TPO and the DRP had rejected the assessee's claim of risk adjustment on the ground that the assessee failed to bring any evidence on the record to show that there exists any difference in the risk profile of the comparable companies vis-a-vis of the assessee. In order to take benefit of this adjustment information should be submitted along with details under rule 10D maintained by the assessee. Under s. 92D(I) of the Act provide that every person entering in to an international transaction is required to keep and maintain such information and document in respect thereof, as is being prescribed under rule 10D (I) of IT Rules. This rules required maintenance of a record of the analysis performed to evaluate comparable as well as a record of the actual working carried out for determining the ALP. Under rule 10D (4) of the I.T. rules requires that the information and documentation to be maintained. Under rule 10D(1) should be contemporaneous as for as possible and should exist latest by the due date of filing of the return. The assessee admitted that they did not undertake any risk adjustment in the TP document report. In the absence of that comparability, it is difficult to make adjustment. As for as the decision of the ITAT is concerned, that relates to facts of the relevant cases. In a given circumstance, some estimate mark upon may not be applied for risk adjustment. The assessee ought to have demonstrated this factor before the TPO as well as before the DRP.

Rely on the following case laws.

- *M/s. Marubeni India Private Limited vs. Addl. CIT* ITA No 945/Del/2009.
- *Symantec Software Solution Private Limited vs. ACIT* ITA No/7894/Mum/2010
- *Exxon Mobil Company India Pvt. Ltd vs. DCIT* ITA No 8311/Mum/2010
- *ADP (P) Ltd vs. DCIT*, ITA No 106/Hyd/2009
- *Vedaris Technology (P) Ltd vs. ACIT* (2010) 131 TTJ (Del) 309
- *M/s. Deloitte Consulting India Pvt. Ltd vs. DCIT*
- *ST Micro Electronics Pvt. Ltd vs. CIT(A)*, ITA No 1806, 1807/Del/2008

In view of the facts as well as legal position discussed above, this issue raised by the assessee is devoid of merit and is liable to be rejected.

Benefit of 5 percent range.

In para-16 of the TPO's order held that proviso to s. 92C (2) was amended with effect from 01.10.2009 by introducing a clarificatory amendment. The second provision says that if arithmetical mean price determined is within +/-5% from price charged in the international transaction, the price charged by the tax payer has been treated as arm's length price. No adjustment would be made, if the arithmetical mean price falls beyond +/-5% from the price charged in the international transaction, and then second proviso is not applicable. In such case, only the first proviso shall alone applicable as per which the arithmetical mean price shall be taken to be the arm's length price. Meaning thereby, the transfer pricing adjustment would be made only from arithmetical mean price. Thus according to the TPO, by virtue of amendment the +/-5% variation is allowable only the case of the price charged in the international transactions and not for the adjustment. The DRP also uphold the TPO's stands.

On the other hand, the assessee submitted that the proviso to sub-section (2) of section 92C as added by finance (No-2) Act 2009 is prospective in operation will be applicable only after 1.10.2009 therefore they prayed that the TPO may be directed to provide deduction of 5% from the ALP determined by him. It had placed reliance on a number of case laws:–

In this context, the Revenue had relied on the findings of the Hon'ble ITAT, Delhi in the case of *M/s. Marubeni India Private Limited vs. Addl.CIT* ITA No 935/DEL/2009. Similar view also taken in the case of –

- *DCIT vs. Global Vantadge Pvt. Ltd* (2010-T10L-24-ITAT-DEL)
- *DCIT vs. Bast India Ltd* (41 SOT 10)
- *M/s.Deloitte Consultancy India Pvt. Ltd vs. DCIT* ITA No 1084/Hyd/2010
- *Exxon Mobil Company India Pvt. Ltd vs. DCIT* ITA No 8311/Mum/2010
- *ST Micro Electronics Pvt. Ltd vs. CIT* (A) ITA No.1806,1807/Del/2008
- *ADP (P) Ltd vs. DCIT*, ITA No 106/Hyd/2009
- *Wrigley India (P) Ltd vs.. Addl. CIT*, ITA No 5224/Del/2010, (2011) 62 DTR (Del) (Trib) 201

The decisions cited above, support the TPO's view. Therefore the claim of the assessee on this issue deserves for rejection. In conclusion, the Ld. D R forcefully pleaded that the stand of the TPO and the DRP requires to be sustained.

In the rejoinder, it was submitted by the learned counsel for the assessee that on page 4 of the Note filed by the Ld. D.R, it is stated that the appellant did not raise the issue of cross examination before TPO/DRP. In this regard, the appellant submitted that it made specific request for cross examination before the TPO as well as DRP. It was submitted that the appellant's contention was also supported the Note of the Ld. DR (page 26) wherein the Ld. DR had extracted the submission of the appellant and acknowledged therein that appellant had requested for cross examination.

The Ld. D R (on pages 27 & 28 of the Note), it was stated that in case of KALS, Rs.1.27 crores which was contended by the appellant as inventory was actually receivable from customers. It was, further, contended by the Ld. D.R that the appellant was giving misleading facts. To counter this, it was submitted by the appellant that as per Annual Report of KALS Rs.1.27 crores was in fact inventory. Sundry debtors were separately mentioned in the Annual Report. This was clear from the annual report of KALS for FY 2005-06 wherein Rs.1.27 crores was reflected as inventory and sundry debtors were separately shown. The Ld. D.R'S contention that the appellant did not raise the issue of conversion of warrants in case of Mindtree before the TPO/DRP was also factually incorrect as the appellant had made submissions on this issue before the TPO as well as DRP.

7. We have duly considered rival submissions, diligently perused the relevant case records and also voluminous Paper Books furnished by the Ld. A.R. With due respects, we have also perused various case laws on which either party had placed their unstinted confidence.

The prime thrust and grievances of the appellant being:

(i) no reasonable opportunity of hearing provided by the Ld. TPO and during the hearing before the DRP, only one opportunity was afforded;

(ii) that the TPO had selected six companies in the order passed u/s 92CA of the Act as comparables in addition to those proposed in the notice without giving an opportunity to the appellant to present its objection(s)/comments;

(iii) Even under TNMM, considering turnover range of Rs.1 crore to Rs.200 crores and Rs.1 crore to Rs.500 crores and rejecting certain comparables selected by TPO, the appellant's transactions were at arm's length;

(iv) Six companies which did not even appear in the initial search list of the TPO were issued notice u/s 133(6) of the Act to collate information. The process adopted in issuing notice u/s 133 (6) of the Act was not detailed. The information obtained in response thereto had not been fully shared;

(v) Details of information were not given to the appellant and that the DRP had stated that was intentional;

(vi) Copies of subsequent notices u/s 133(6) of the Act issued by the TPO and replies received there-from were not given to the appellant, for which, DRP in its impugned orders stated that the same was not relevant and, hence, not required to be given'

(vii) Difference between replies received u/s 133(6) and annual reports have been tabulated by the appellant. No comments have been made on the same either by the TPO or DRP. No opportunity was extended as sought for to cross-examine in cases where replies u/s 133(6) of the Act have been relied upon; The DRP in its impugned order stated that the office of the TPO cannot be converted into an office granting opportunity of cross –examination to the appellant;

(viii) The appellant had made detailed submissions for rejection of KALS as comparable, however, the appellants submissions have not been commented either by the TPO or the DRP;

(ix) In the case of Megasoft, the TPO and the DRP have considered entity-wide margins on the ground that software product segment also consists software services and, therefore, at entity level software services were more than 75% of operating revenues. However, similar situation in the case of other comparables have been ignored. If at all Megasoft was to be adopted as a comparable, the margin of the software segment may be used; &

(x) Benefit of 5% deduction in determining the arm's length price in accordance with proviso to s.92C of the Act not given.

7.1. After analyzing the submissions of rival parties and also deliberating the specific apprehensions of the appellant as narrated above, the matter has now been narrowed down for consideration to twin issues, namely:

(1) ***What is the data to be considered by the TPO at the time of determining ALP? &***

(2) ***Whether the appellant should have been given an opportunity to refute the material sought to be utilized by the TPO?***

7.2. As far as the data to be used by the TPO while determining the ALP was concerned, it is observed that it is covered by the provisions of rule 10D sub-rule 4 of the Income-tax Rules. Section 92 C provides that the arm's length price in relation to an international transaction shall be determined by any of the methods being the most appropriate method having regard to the nature of transaction or class of transaction or class of associated persons or functions performed by such persons or such

other relevant factors for computing the ALP and also any other method as may be prescribed by the Board. S. 92D provides that (i) every person who has entered into an international transaction shall maintain and keep such information and documents in respect thereof; (ii) the Board may also prescribe the period for which the information and documents shall be kept and maintained; and (iii) the AO or the CIT (A) may, in the course of any proceeding under the Act, require any person who has entered into an international transaction to furnish any information or document in respect thereof. Thus, it subscribes that the requirement is only to maintain and keep the information and documents relating to international transactions so that they are available as and when required during any proceeding under the Act. The section does not provide that the information and documents are to be kept and maintained for a period of eight years. Rule 10-D (1) specifies the documents and information which are to be kept and maintained by the assessee and sub-rule 2 thereof provides that nothing contained in sub-rule 1 shall apply in a case where the aggregate value as recorded in the books of accounts, the international transactions entered into by the assessee does not exceed Rs.1 crore. Sub-rule 3 provides the supporting authentic documents which are to be kept and maintained and sub-rule 4 thereof provides that the information and documents specified under sub-rule 1 & 2 should as far as possible be contemporaneous and should exists latest by the 'specified date' referred to in clause-4 of s.92F. Clause 4 of s. 92F gives the definition of 'specified date' to have the same meaning as assigned to 'due date' in Expln. 2 below sub-section 1 of s.139. Explanation 2 to s.139 defines 'due date' in a case of a company to be 30th of September of the relevant assessment year, the assessee is supposed to maintain information and documents. After going through the above provisions of law, it is clear that the Act has not provided for any cut off date up-to which only the information available in public domain has to be taken into consideration by the TPO, while making the transfer pricing adjustments and arriving at arm's length price. The assessee as well as the Revenue is both bound by the Act and the rules there-under and, therefore, as provided under the Act and rules, they are supposed to be taking into consideration, the contemporaneous data relevant to the previous year in which the transaction has taken place. The assessee had strenuously argued that the provisions of s.92D and Rule 10D is defeated, if the TPO takes the data which is available in the public domain after the specified date and the ALP would be fluid and there would be no certainty for the same. We are, however, not in agreement with the arguments put-forth by the Ld. A.R. The ALP has to be determined by the TPO in accordance with law and the Act provides that the TPO shall take into consideration the contemporaneous data. The assessee was only required to maintain the information and documents as may be necessary relating to the international transactions so that it can be made available to the TPO or the AO or any other authority in any proceedings under the

Act. By providing a specified date in the Act, the obligation is cast upon the assessee to keep and maintain the documents for that period. But, it does not restrict the TPO from making enquiries thereafter for determining the correct ALP.

7.3 Having held so, we shall now glimpse at the next question, as to whether the TPO can make his own enquiries and call for information from various entities keeping the assessee in the dark. Under sub-sec. (3) & (7) of Sec. 92CA, the TPO is entrusted with all the powers under clauses (a) to (d) of sub-section (1) of 131 or sub-section (6) of s.133 to call for and gather any information as may be required. When the TPO is making the search for a relevant comparable, he can issue notices to the parties whom he considers as relevant to gather requisite information and on being satisfied with regard to relevancy of the material which can be used against the assessee only then the assessee has to be given an opportunity of presenting its objections, if any. Thus, the TPO need not inform the assessee about the process used by him for issuing the notices u/s 133(6) of the Act nor is he under any obligation to furnish the entire information to the assessee.

7.4. However, we are of the firm view that the principles of natural justice requires that when any information is sought to be used against the appellant, the appellant has to be given a reasonable opportunity of hearing on that material. In the present case, the TPO had furnished all the information to the appellant in the form of CD and the appellant, after perusing the same, had submitted a detailed submission along with its objections for taking various companies as comparables. It was another matter, if the TPO had not considered the objections of the appellant judiciously. In such a case, it would be an error of judgment, but, not violation of principles of natural justice. The objections of the appellant were that certain companies have been taken into consideration by the TPO as comparables without affording the appellant an opportunity of furnishing its objections, if any, and also with regard to certain other companies, it had sought opportunity to cross-examine them, but, it has been observed that no such an opportunity has been extended to the appellant.

7.5. As recorded earlier, if any information is sought to be used against the appellant, the same has to be furnished to the appellant and thereafter, taking into consideration the appellant's objections, if any, only then can the TPO proceed to take a decision. If the appellant seeks an opportunity to cross-examine the parties concerned, the appellant shall be provided such an opportunity. It is only during a cross-examination that the appellant can rebut the stand of that particular party (company). As listed out earlier, the appellant had also brought out various defects in the additional comparables selected by the TPO and had brought out the striking differences between the functions of those comparables as compared to the appellant and also as to how the entire revenue of the appellant has been

taken into consideration in spite of there being income from unrelated party transactions also. All these objections have been detailed in its written submission which has also been incorporated in this order in a summarized manner. It has been observed that the TPO had not considered those objections while determining the ALP. Further, it was also the stand of the appellant that it should be given a standard deduction of 5% as provided under the proviso to s.92C (2) before making adjustments for the transfer price. To drive home its point, the appellant had placed strong reliance on the following decisions:

- *M/s. Sap Labs India Pvt. Ltd vs. ACIT* 2010-T II-44-ITT-BANG-TP;
- *Philips Software Centre Pvt Ltd.* 26 SOT 226;
- *MSS India Private Limited* 32 SOT 132
- *Customer Services India (P) Ltd vs. ACIT* 30 SOT 486;
- *Skoda Auto India Pvt. Limited vs. ACIT* 2009-TIOL-214-ITAT-Pune;
- *Development Consultants P. Ltd vs. DCIT* 23 SOT 455;
- *Sony India P. Ltd* 315 ITR 150;
- *Cummins India Limited vs. DCIT* ITA No.277 & 1412/PN/07;
- *TNT India Pvt. Ltd vs. ACIT* 10 Taxmann. Com 161;
- *(10)Abhishek Auto Industries Ltd vs. DCIT* 2010-T II-54-ITAT, DEL-TP; &
- *(11)Technimont ICB Pvt. Ltd vs. ACIT* 2011-T II-31-ITAT-MUM-TP

7.6. On the other hand, the Ld. D R, placing strong reliance on the stand of the authorities below, submitted that 5% was not the standard, but, it was the range within which if the ALP fails, then, the ALP of the appellant has to be accepted. We have considered rival submissions and of the firm view that this issue has already been covered by the decisions which have been relied on by the appellant.

7.7. Turnover Filter: As regard the assessee's objection of TPO adopting infinity figures for upper limit turnover for the selection of comparables, we find that the issue is squarely covered by the order of Bangalore Bench of Tribunal in the case of M/s Genisys Integrating Systems (India) Pvt. Ltd. The relevant finding of the Tribunal at para 9 reads as follows:-

> *"9. Having heard both the parties and having considered the rival contentions and also the judicial precedents on the issue, we find that the TPO himself has rejected the companies which are making losses as comparables. This shows that there is a limit for the lower end for identifying the comparables. In such a situation,*

we are unable to understand as to why there should not be an upper limit also. What should be upper limit is another factor to be considered. We agree with the contention of the learned counsel for the assessee that the size matters in business. A big company would be in a position to bargain the price and also attract more customers. It would also have a broad base of skilled employees who are able to give better output. A small company may not have these benefits and therefore, the turnover also would come down reducing profit margin. Thus, as held by the various benches of the Tribunal, when companies which are loss making are excluded from comparables, then the super profit making companies should also be excluded. For the purpose of classification of companies on the basis of net sales or turnover, we find that a reasonable classification has to be made. Dun & Bradstreet and NASSCOM have given different ranges. Taking the Indian scenario into consideration, we feel that the classification made by Dun & Bradstreet is more suitable and reasonable. In view of the same, we hold that the turnover filter is very important and the companies having a turnover of Rs.1.00 crore to 200 crores have to be taken as a particular range and the assessee being in that range having turnover of 8.15 crores, the companies which also have turnover of 1.00 to 200.00 crores only should be taken into consideration for the purpose of making TP study".

In the instant case, the turnover of the company is in the range of 24 crores, therefore, the companies, which have turnover of Rs.1.00 crores to 200 crores alone should be taken into consideration for the purpose of making TP study.

7.8 In these circumstances, we are of the considered view that this issue requires to be remitted back to the file of the TPO for fresh consideration with the following directions:

(i) the operating revenue and the operating cost of the transactions relating to associated enterprises only shall be considered;

(ii) the comparables having the turnover of more than Rs.1 crore, but, less than Rs.200 crores only shall be taken into consideration;

(iii) all the information relating to comparables which were sought to be used against the appellant shall be furnished to the appellant;

(iv) the appellant shall also be extended an opportunity to cross-examine the parties whose replies were sought to be used against the appellant;

(v) to consider the objections of the appellant that relate to additional comparables sought to be adopted by the TPO and to pass a detailed order; and

(vi) to give the standard deduction of 5% under the proviso to s.92C(2) of the Act.

7.9. Before parting with, we would like to recall that most of the issues raised in this appeal with regard to TP study had also cropped up in the case of *M/s. Genisys Integrating Systems (India) Pvt. Ltd vs. DCIT* in ITA No.1231 (Bang)/2010 dated: 5-8-2011 (Assessment Year 2006-07) wherein the Hon'ble Bench, after due consideration, had taken similar views.

8. With regard to deduction u/s 10A of the Act, it was contended by the appellant that the AO reduced Rs.5,27,929/- from the export turnover, however, the same has not been reduced from the total turnover. It was, further, submitted that what was reduced from export turnover should also be reduced from the total turnover.

8.1 The learned AR submitted that the issue in question is squarely covered by the judgement of the Hon'ble Karnataka High Court in the case of *CIT vs. M/s Tata Elxsi Ltd. & Others* (2011-TIOL-684-HC-KAR-II), Hon'ble Mumbai High Court in the case of *CIT vs. Gem Plus Jewellery India Ltd.* 330 ITR 175 and the order of the Special Bench in the case of *ITO vs. M/s Sak Soft Ltd.* 313 ITR 353. The learned DR was unable to controvert the submissions of the learned AR.

8.2. We have heard the rival submission and perused the material on record. The Hon'ble Karnataka High Court in the case of CIT v M/s Tata Elxsi Ltd. & Others had held that while computing the exemption u/s 10A, if the export turnover in the numerator is to be arrived at after excluding certain expenses, the same should also be excluded in computing the export turnover as a component of total turnover in the denominator. The relevant finding of the Hon'ble jurisdictional High Court reads as follows:–

> *"……….Section 10A is enacted as an incentive to exporters to enable their products to be competitive in the global market and consequently earn precious foreign exchange for the country. This aspect has to be borne in mind. While computing the consideration received from such export turnover, the expenses incurred towards freight, telecommunication charges, or insurance attributable to the delivery of the articles or things or computer software outside India, or expenses if any incurred in foreign exchange, in providing the technical services outside India should not be included. However, the word total turnover is not defined for the purpose of this section. It is because of this omission to define 'total turnover', the word 'total turnover' falls for interpretation by this Court;*
>
> *……..In section 10A, not only the word 'total turnover' is not defined, there is no clue regarding what is to be excluded while arriving at the total turnover. However, while interpreting the provisions of section 80HHC, the courts have laid down various*

principles, which are independent of the statutory provisions. There should be uniformity in the ingredients of both the numerator and the denominator of the formula, since otherwise it would produce anomalies or absurd results. Section 10A is a beneficial section which intends to provide incentives to promote exports. In the case of combined business of an assessee, having export business and domestic business, the legislature intended to have a formula to ascertain the profits from export business by apportioning the total profits of the business on the basis of turnovers. Apportionment of profits on the basis of turnover was accepted as a method of arriving at export profits. In the case of section 80HHC, the export profit is to be derived from the total business income of the assxcessee, whereas in section 10-A, the export profit is to be derived from the total business of the undertaking. Even in the case of business of an undertaking, it may include export business and domestic business, in other words, export turnover and domestic turnover. To the extent of export turnover, there would be a commonality between the numerator and the denominator of the formula. If the export turnover in the numerator is to be arrived at after excluding certain expenses, the same should also be excluded in computing the export turnover as a component of total turnover in the denominator. The reason being the total turnover includes export turnover. The components of the export turnover in the numerator and the denominator cannot be different. Therefore, though there is no definition of the term 'total turnover' in section 10A, there is nothing in the said section to mandate that, what is excluded from the numerator that is export turnover would nevertheless form part of the denominator. When the statute prescribed a formula and in the said formula, 'export turnover' is defined, and when the 'total turnover' includes export turnover, the very same meaning given to the export turnover by the legislature is to be adopted while understanding the meaning of the total turnover, when the total turnover includes export turnover. If what is excluded in computing the export turnover is included while arriving at the total turnover, when the export turnover is a component of total turnover, such an interpretation would run counter to the legislative intent and impermissible. Thus, there is no error committed by the Tribunal in following the judgements rendered in the context of section 80HHC in interpreting section 10A when the principle underlying both these provisions is one and the same".

8.3. The Hon'ble Mumbai High Court in the case of Gem Plus Jewellery India Ltd. (supra), in identical circumstances, held that since the export turnover forms part of the total turnover, if an item is excluded from the export turnover, the same should also be reduced from the total turnover to maintain parity between numerator and

denominator while calculating deduction u/s 10A of the Act. The relevant finding of the Hon'ble Mumbai High Court reads as follows:–

> *"The total turnover of the business carried on by the undertaking would consist of the turnover from export and the turnover from local sales. The export turnover constitutes the numerator in the formula prescribed by sub-section (4). Export turnover also forms a constituent element of the denominator in as much as the export turnover is a part of the total turnover. The export turnover, in the numerator must have the same meaning as the export turnover which is constituent element of the total turnover in the denominator. The legislature has provided a definition of the expression "export turnover" in Expln.2 to s.10A which the expression is defined to mean the consideration in respect of export by the undertaking of articles, things or computer software received in or brought into India by the assessee in convertible foreign exchange but so as not to include inter alia freight, telecommunication charges or insurance attributable to the delivery of the articles, things or software outside India. Therefore in computing the export turnover the legislature has made a specific exclusion of freight and insurance charges. The submission which has been urged on behalf of the revenue is that while freight and insurance charges are liable to be excluded in computing export turnover, a similar exclusion has not been provided in regard to total turnover. The submission of the revenue, however, misses the point that the expression "total turnover" has not been defined at all by Parliament for the purposes of s.10A. However, the expression "export turnover" has been defined. The definition of "export turnover" excludes freight and insurance. Since export turnover has been defined by Parliament and there is a specific exclusion of freight and insurance, the expression "export turnover" cannot have a different meaning when it forms a constituent part of the total turnover for the purposes of the application of the formula. Undoubtedly, it was open to Parliament to make a provision which has been enunciated earlier must prevail as a matter of correct statutory interpretation. Any other interpretation would lead to an absurdity. If the contention of the Revenue were to be accepted, the same expression viz. 'export turnover' would have a different connotation in the application of the same formula. The submission of the Revenue would lead to a situation where freight and insurance, though these have been specifically excluded from 'export turnover' for the purposes of the numerator would be brought in as part of the 'export turnover' when it forms an element of the total turnover as a denominator in the formula. A construction of a statutory provision which would lead to an absurdity must be avoided. Moreover, a receipt such as freight*

> *and insurance which does not have any element of profit cannot be included in the total turnover. Freight and insurance charges do not have any element of turnover. For this reason in addition, these two items would have to be excluded from the total turnover particularly in the absence of a legislative prescription to the contrary – CIT vs. Sudarshan Chemicals Industries Ltd. (2000) 163 CTR (Bom) 596: (2000) 245 ITR 769 (Bom) applied; CIT vs. Lakshmi Machine Works (2007) 210 CTR (SC) 1: (2007) 290 ITR 667 (SC) and CIT vs. Catapharma (India) (P) Ltd. (2007) 211 CTR (SC) 83: (2007) 292 ITR 641 (SC) relied on"*

8.4. In the case of *Sak Soft Ltd.* (supra), the assessee was engaged in the business of exporting computer software and claimed deduction u/s 10B of the Act. In completing the assessment u/s 143(3) of the Act, the AO reduced the expenditure incurred in foreign exchange in providing the technical services outside India, from the export turnover without corresponding reduction from total turnover, thereby reducing the deduction claimed by the assessment u/s 10B of the Act.

8.5. In light of the above facts, the Special Bench held as under:–

> *"For the above reasons, we hold that for the purpose of applying the formula under sub-section (4) of section 10B, the freight, telecom charges or insurance attributable to the delivery of articles or things or computer software outside India or the expenses, if any, incurred in foreign exchange in providing the technical services outside India are to be excluded both from the export turnover and from the total turnover, which are the numerator and the denominator respectively in the formula. The appeals filed by the department are thus dismissed".*

Although the order of Special Bench is in the context of section 10B of the Act, the ratio laid down in the above decision applies to section 10A of the Act as well, as the provisions of sections 10A and 10B are identical on all material aspects. More particularly, both the sections define only export turnover but not total turnover and sub-section (4) of both the sections prescribe an identical formula for computing the export profits.

8.6. Therefore, we direct that Rs.5,72,929/- should be reduced not only from export turnover but also from the total turnover while computing deduction u/s 10A of the Act.

9. The issue of levying of interest u/s 234B and u/s 234D of the Act is mandatory and consequential in nature and, therefore, it has not been addressed to.

10. In the result, the appellant's appeal is treated as partly allowed for statistical purposes.

Order pronounced in the open court on 27th day of January, 2012

2012 PTR 493 (Trib. Ind.)

INCOME TAX APPELLATE TRIBUNAL
VISAKHAPATNAM BENCH, VISAKHAPATNAM

Sunil Kumar Yadav, Judicial Member and BR Baskaran, Accountant Member

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FACTS/HELD

1. **Tribunal's order is binding and failure to follow it is 'Contempt of Court'**
2. Though the Tribunal in the assessee's own case held that exemption u/s 11 was available and the facts were identical, the CIT (A), for a subsequent year, declined to follow it inter alia on *the ground* that the DR had not advanced arguments before the Tribunal in a 'comprehensive and effective manner'. The assessee filed an appeal demanding exemplary costsu/s 254(2B). HELD by the Tribunal after a comprehensive review of the law on the subject:

   It is well settled that the Tribunal is exercising judicial functions and has all powers of a Court. The proceeding before the Tribunal are deemed to be judicial proceedings. It appears to be the impression/ misunderstanding of some tax officials that the orders of the ITAT interpreting the law cannot be binding as it is a fact finding authority. However, this is not correct because the decision of a higher authority in the judicial hierarchy is binding on all the lower authorities below the line. Hence, **the AO & CIT (A) are bound by the decision rendered by the jurisdictional Tribunal. Refusal to follow the order of the ITAT would render that authority guilty of committing contempt of Tribunal for which the concerned authority is liable to be proceeded against**. If the decision of the Tribunal is found to be unacceptable to the authorities below, the right course to follow is to carry the matter in appeal to the High Court and to seek suspension of the operation of the order of the Tribunal. A person occupying the chair of CIT (A) is expected to be aware of judicial

discipline and the binding nature of the Tribunal's order. **To avoid harassment to the assessee and unpleasant circumstances, the CBDT should take appropriate steps to enlighten all officials to ensure that judicial discipline is maintained**. Costs u/s 254(2B) can be granted only if frivolous appeals are filed and not in a case like this. However, the assessee is free to take proper steps for initiating contempt proceeding against the CIT(A) (**Ajay Gandhi vs. B.Singh** 265 ITR 451 (SC), **ITAT vs. V.K.Agarwal** 235 ITR 175 (SC) & **Agarwal Warehousing and Leasing** 257 ITR 235 (MP) followed)

Appeals allowed.

ITA Nos.152 to 156/Vizag/2011 Assessment Years : 1997-98, 1998-99, 2005-06, 2006-07 & 2007-08 Respectively.

Decided on: 19th July, 2011.

Present at hearing: C.P. Ramaswami, Advocate, for Appellant. TH.L. Peter, CIT (DR), for Respondent.

JUDGMENT

Per Bench:–

These appeals filed by the assessee are directed against the common order dated 31.1.2011 passed by learned CIT(A), Visakhapatnam for the years cited (Supra).

2. (a) The assessee is challenging the order of Learned CIT(A) on various issues with the plea that all the issues raised by the assessee were decided by the Jurisdictional ITAT in the assessee's own case, vide its order dated 08-01-2010 in ITA Nos.272 to 274/Vizag/2005.

(b) The assessee has also raised following ground seeking cost for not following the order of the Jurisdictional ITAT:

> "The learned CIT (Appeals) has committed contempt of the Hon'ble ITAT Vizag Bench by his decision in not following the order of the jurisdictional Bench of ITAT in the same assessee's case on the same issues and thereby it is prayed that exemplary cost should be awarded in terms of subsection (2B) of section 254 of Income tax Act, 1961 for forcing this assessee to file this appeal".

3. The facts relating to the case are stated in brief. The assessee is a trust formed in January 1994 by two trade associations viz., M/s Visakhapatnam Stevedores Association and M/s Customs clearance and Forwarding Agents Association, with an objective of regulating the employment of private workers in the dock works in Visakhapatnam port. The assessee was granted registration under section 12A of the Act by the

then Learned CIT, Visakhapatnam from the date of its inception and there is no dispute that the said registration is still in force. The assessing officer, for the reasons stated in the assessment order of the years under consideration, declined to grant exemption under section 11 to the income of the Act despite the fact that the assessee is having registration granted by Learned CIT under section 12A of the Act. It is pertinent to mention here that the Assessing Officer had denied exemption under section 11 to the assessee on identical reasons for the assessment years 1999-2000 to 2004-05 also and his orders were sustained by Learned CIT(A). The assessee carried the matter in appeal to the Tribunal and this bench of ITAT, vide its order dated 08-01-2010, held that the assessee is entitled to exemption under section 11 of the Act.

3.1 As stated earlier, the assessing officer denied exemption to the assessee for the years under consideration also on identical reasons, which had been decided by the Tribunal. When the appeals filed by the assessee for the impugned years before Learned CIT(A) was heard, the assessee placed a copy of the order of the ITAT cited above. However, the Learned CIT(A), without appreciating the binding force of the jurisdictional Tribunal's order, went on to make following observations:

> *(ii) A careful perusal of the order of the honourable Supreme Court in the case of ACIT Vs. Surat City Gymkhana ((Supra)) gives the impression that such decision is not an authority for the proposition that grant of registration u/s 12A of the Act once done is a fait accompli and bars the assessing officer from dwelling on the same question once again in the assessment proceedings, but an authority for the proposition that the if it had in the past accepted similar order, following which the latter order has been passed. Even otherwise, the above proposition does not represent correct position of law in as much as a three judge bench of the honourable Supreme Court in the case of Maharashtra vs. Digambar [1995 (4) SCC 683] has held that merely because the state did not prefer an appeal against an earlier order, it does not estop the state from challenging the subsequent orders passed by the High Court adverse to its interest. To err is human. Any authority, howsoever senior, may commit mistake and, therefore, nobody is infallible. If registration u/s 12A is erroneously granted by the concerned Commissioner, without appreciating that the true import of the declared predominant object is commercial and not charitable in nature, as could be found out during the course of the assessment proceedings, it would be a travesty of justice to accept the non-charitable objects coupled with lack of any charitable activity as charitable in nature and confer the benefit of exemption u/s 11 of the Act. In this view of the matter, the then Commissioner of*

> *Income-tax, Visakhapatnam, who had granted registration to the appellant trust may have committed an error in overlooking the business nature of the dominant objective of the appellant trust. But justice cannot be sacrificed on the altar of technicalities, and, hence, the action of the assessing officer, in refusing exemption to the appellant on the ground, interalia, of the predominant object being non-charitable in nature is, hereby, strongly, upheld.*
>
> *(iii) It appears that at the time of hearing of the quantum appeals of the appellant for the assessment years 1999-2000 to 2004-05 before the honourable Tribunal, the department representative has not been able to advance the arguments relating to the issue in a comprehensive and effective manner so as to plead that the jurisdictional Commissioner who granted registration u/s 12A to the appellant trust had indeed failed to apply his mind properly to the objects professed by the appellant trust and had, thus, erroneously granted registration to the appellant trust as a charitable trust."*

Thus, it can be seen that the Learned CIT(A) has failed to give any concrete decision on the issue of denying exemption to the assessee under section 11 of the Act. However, in the concluding paragraph of his order, the Learned CIT(A) has made following observations:

> "Therefore, it is in the fitness of things that the Assessing Officer should take steps to intimate the concerned jurisdictional Commissioner of Income tax about the predominantly commercial objective of supplying of labour force to the stevedores and clearing and forwarding agents for their day to day business activities at Visakhapatnam port and for not having carried out any charitable activity hitherto, for the purpose of cancellation of registration under section 12AA of the Act. Alternatively, the jurisdictional Commissioner may consider taking suo motu cognizance of the lack of charitable activities so far for the purpose of cancellation of registration under section 12AA granted earlier to the appellant trust".

Hence it is not clear whether or not the Learned CIT(A) is upholding the action of Assessing Officer in denying exemption to the assessee under section 11 of the Act vis-à-vis the reasons given by the Assessing Officer for such denial, despite there being a decision of Jurisdictional Tribunal holding that the assessee is entitled to exemption under section 11 of the Act. With regard to the issue of alleged violation of the provisions of sec.13(1)(c) r.w.s. 13(2) , the Learned CIT(A) apparently did not follow the decision of the ITAT rendered on the very same issue on identical facts.

4. Now the question that arises is whether the Learned CIT(A) can refuse to follow the orders of the jurisdictional ITAT. We feel it appropriate to dwell upon some of the judicial rulings given by various courts on the impugned matter.

5. We shall first discuss about the nature and status of the Income tax Appellate Tribunal in the judicial hierarchy of our country. The Hon'ble Supreme Court, in the case of Ajay Gandhi Vs. B.Singh (2004) (265 ITR 451), has discussed about the status of the Income tax Appellate Tribunal as under:

> "The Appellate Tribunal constituted under the Act is not an income tax authority. It is the ultimate fact-finding authority under the Act and only a reference to the High Court or this Court on a question of law from its order can be made (see *Udhavdas Kewalram vs. CIT* (1967) 66 ITR 462 (Supreme Court)).... **The position of the Appellate Tribunal is the same as of a court of appeal under the Civil Procedure Code and its powers are identical with the powers enjoyed by the appellate court there under** (see *New India Life Assurance Co. Ltd vs. CIT* (1957)(31 ITR 844 (Bom)).... The Income tax Appellate Tribunal exercises judicial functions and has the trappings of a court."

5.1 In the case of *ITAT vs. V.K. Agarwal* (235 ITR 175 (S.C)), the respondent (Ex-Law Secretary, Ministry of Law and Justice, Government of India) initially raised a technical objection about the status of the Income tax Appellate Tribunal. The observations made by Hon'ble Supreme Court in this regard (at page 182) are extracted below:

> "Before examining the conduct of the first respondent, we would like to deal with the technical objections which were raised before us on behalf of the first respondent. The first respondent had initially contended that the Income tax Appellate Tribunal was not a court, and was also not a court subordinate to the Supreme Court. Hence, the Supreme Court had no jurisdiction to issue a suo motu notice of contempt in respect of a matter pertaining to the Income tax Appellate Tribunal. **However, subsequently, learned senior counsel for the first respondent conceded that the Income tax Appellate Tribunal did perform judicial functions and was a court subordinate to the High Court**. Hence there is no need to examine any further, the contention that the said Tribunal is not a court."

In the said case, the Hon'ble Supreme Court further held as under:

> **"This court has consistently held that the Supreme Court has power under this article to punish, not merely for contempt of itself, but also for contempt of all courts and**

Tribunals subordinate to it. In the case of *Delhi judicial Service Association, Tis Hazari Court, Delhi vs. State of Gujarat*, AIR 1991 Supreme Court 2176; (1991) 3 SCR 936, this court examined at length the power of this court under article 129 to punish for contempt. This court first examined the jurisdiction of the Supreme Court and held (at page 970 and page 2194 of AIR 1991 Supreme Court): "There is therefore no room for any doubt that this court has wide power to interfere and correct the judgment and orders passed by any court or Tribunal in the country. In addition to the appellate power, the court has special residuary power to entertain appeal against any order of any court in the country. The plenary jurisdiction of this court to grant leave and hear appeals against any order of a court and Tribunals confers power of judicial superintendence over all the courts and Tribunals in the territory of India including subordinate courts of Magistrate and District Judge. This court has, therefore, supervisory jurisdiction over all courts in India." Examining the powers of a court of record, it came to the conclusion that **a court of record has inherent power to punish for contempt of all courts and Tribunals subordinate to it in order to protect these subordinate courts and Tribunals.....**

It was also submitted before us by learned senior counsel for the first respondent that although this court may have jurisdiction to punish for contempt, that jurisdiction should not be exercised in the present case. The appropriate authority to take action would be the High Court. We do not see much force in this submission. **The Income tax Appellate Tribunal, although it may have Benches in different parts of the country, is a national Tribunal and its functioning affects the entire country and all its Benches.** Appeals also lie ultimately to this court from the decisions and references made by the Tribunal. The mere fact that by this court taking suo motu cognizance of the contempt, the first respondent would not be able to appeal to any other court, cannot be a ground for not exercising **the power to punish for contempt of a national Tribunal.**"

5.2 Since the Income tax Appellate Tribunal is exercising judicial functions, it is now settled that it has all powers of Court, i.e. it can issue summons and exercise all the powers vested in the Income tax authorities under section 131 of the Income tax Act. Hence any proceeding before the Income tax Appellate Tribunal shall be deemed to be judicial proceedings.

6. Next we shall dwell upon the judicial rulings about the binding nature of orders passed by the Income tax Appellate Tribunal. The Hon'ble MP High Court in the case *Agarwal Warehousing and Leasing*

Ltd. vs. CIT (257 ITR 235) has held that the orders passed by the tribunal are binding on all the tax authorities functioning under the jurisdiction of the tribunal. While so holding, it followed the decision of the Hon'ble Supreme Court in the case of *UoI vs. Kamlakshi Finance Corporation Ltd* (AIR 1992 Supreme Court 711, 712) 55 ELT 433 (S.C) which has ruled as under:

> "It cannot be too vehemently emphasized that it is of utmost importance that, in disposing of the quasi-judicial issues before them, revenue officers are bound by the decisions of appellate authorities. The order of the Appellate collector is binding on the Assistant Collectors working within his jurisdiction and the order of the Tribunal is binding upon the Assistant Collectors and the Appellate Collectors who function under the jurisdiction of the Tribunal. The principles of judicial discipline require that the orders of the higher appellate authorities should be followed unreservedly by the subordinate authorities. The mere fact that the order of the appellate authority is not "acceptable" to the Department – in itself an objectionable phrase – and is the subject matter of an appeal can furnish no ground for not following it unless its operation has been suspended by a competent court. If this healthy rule is not followed, the result will only be undue harassment to the assessees and chaos in administration of tax laws".

The Hon'ble M.P High Court further observed in clear terms as under:

> "**Obviously, the Commissioner of Income tax (Appeals) not only committed judicial impropriety but also erred in law in refusing to follow the order of the Appellate Tribunal**. Even where he may have some reservations about the correctness of the decision of the Tribunal, he had to follow the order. He could and should have left it to the Department to take the matter in further appeal to the Tribunal and get the mistake, if any, rectified."

6.1. The Hon'ble M.P High Court in the case referred (Supra) has placed reliance on the decision of Hon'ble Supreme Court in the case of Kamalakshi Finance Corporation Ltd (Supra). We fell it pertinent to extract the relevant observations made by Hon'ble Supreme Court in the said case, which is given in the book of Sampath Iyengar's "Law of Income tax" 10th edition (at page 212), for the purpose of obtaining clarity on the impugned issue:

> "The learned Additional Solicitor General submits that the learned judges have erred in passing severe strictures (1990) 47 ELT 231 (Bom) against the two Assistant Collectors who had dealt with the matter. He submitted that these officers had

given reasons for classifying the goods under heading 39.19 and not 85.46 and could do no more. He submitted that they acted bona fide in the interests of Revenue in not accepting a claim which, they felt, was not tenable. Sri Reddy is perhaps right in saying that the officers were not actuated by any mala fides in passing the impugned orders. They perhaps genuinely felt that the claim of the assessee was not tenable and that, if it was accepted, the Revenue would suffer. But what Sri Reddy overlooks is that **we are not concerned here with the correctness or otherwise of their conclusion or of any factual mala fides but with the fact that the officers, in reaching their conclusion, by-passed two appellate orders in regard to the same issue which were placed before them, one of the Collector (Appeals) and the other of the Tribunal**. The High Court has, in our view, rightly criticized this conduct of the Assistant Collectors and the harassment to the assessee caused by the failure of these officers to give effect to the orders of authorities higher to them in the appellate hierarchy. The impression or anxiety of the Assistant Collector that, if he accepted the assessee's contention, the department would lose revenue and would also have no remedy to have the matter rectified is also incorrect. Section 35E confers adequate powers on the department in this regard. In the light of these amended provisions, there can be no justification for any Assistant Collector or Collector refusing to follow the order of the Appellate Collector or the Appellate Tribunal, as the case may be, even where he may have reservations on its correctness. He has to follow the order of the higher appellate authority. This may instantly cause some prejudice to the Revenue but the remedy is also in the hands of the same officer. He has only to bring the matter to the notice of the Board or the Collector so as to enable appropriate proceedings being taken under section 35E(1) or (2) to keep the interests of the department alive. If the officers' view is the correct one, it will no doubt be finally upheld and the revenue will get the duty, though after some delay which such procedure would entail. **It is clear that the observations of the High Court, seemingly vehement, and apparently unpalatable to the Revenue, are only intended to curb a tendency in revenue matters which, if allowed to become widespread, could result in considerable harassment to the assessee public without any benefit to the Revenue**. We would like to say that the department should take these observations in the proper spirit. The observations of the High Court should be kept in mind in future and **utmost regard should be paid by the adjudicating authorities and the appellate**

> **authorities to the requirements of judicial discipline and the need for giving effect to the orders of the higher appellate authorities which are binding on them.**"

Further in *Khalid Automobiles vs. UoI* (1995) (4 SCC (Suppl.) 652), the Hon'ble Apex Court held that an order of Tribunal was binding on the Assessing officer and the first appellate authority and the failure to follow the same may constitute contempt of Tribunal's order. Similar views have been expressed in Sales tax matters in *Rajendra Mills ltd vs. Jt. CIT* (1971) 28 STC 483 (mad), *Senthil Raj Metals vs. GTO* (1990) 79 STC 38 (Mad).

6.2 The jurisdictional Hon'ble Andhra Pradesh High Court, in the case of State of Andhra Pradesh Vs. Commercial Tax officer and another (169 ITR 564) had an occasion to discuss about the binding nature of the decision of High Court. It held that the Tribunals functioning within the jurisdiction of a particular High Court in respect of whom the High Court has the power of superintendence under article 227 are bound to follow the decisions of the High Court unless, on an appeal to the Supreme Court, the operation of the judgment is suspended. It further held that it is not permissible for the authorities and the Tribunals to ignore the decisions of the High Court or to refuse to follow the decisions of the High Court on the pretext that an appeal has been filed in the Supreme Court which is pending or that steps are being taken to file an appeal. The Jurisdictional High Court, at page 571, has made a reference to the decision of Hon'ble Bombay High Court in the case of *Subramanian, ITO vs. Siemens India Ltd* (1985) (156 ITR 11) and the relevant observations are extracted below:

> "Reference may also be invited to the decision of the Bombay High Court in *Subramanian, ITO vs. Siemens India Ltd* (1985)(156 ITR 11). The question that arose for consideration in this case is whether the Income tax officer is bound by the decision of a single judge or a Division bench of the court within whose jurisdiction he is operating even if an appeal has been preferred against such decision and is pending. The following observations of the Bombay High Court may be extracted (p 12):
>
> > "So far as the legal position is concerned, the Income tax officer would be bound by a decision of the Supreme Court as also by a decision of the High Court of the State within whose jurisdiction he is functioning, irrespective of the pendancy of any appeal or special leave application against that judgment. He would equally be bound by a decision of another High Court on the point, because not to follow that decision would be to cause grave prejudice to the assessee. Where there is a conflict between different High Courts, he must follow the decision of the High Court within whose jurisdiction he is functioning, but if the conflict is between

> decisions of other High Courts, he must take the view which is in favour of the assessee and not against him. **Similarly, if the Income tax Appellate Tribunal has decided a point in favour of the assessee, he cannot ignore that decision and take a contrary view, because that would equally prejudice the assessee.**"

There cannot be any dispute that the ratio of the decision of Jurisdictional High Court equally applies to the orders passed by the ITAT also vis-à-vis the authorities down below.

6.3 It is apposite to extract following observations made by Hon'ble Jurisdictional A.P. High Court in the case of *State Of Andhra Pradesh vs. CTO*, referred (Supra), as we also come across numerous instances of such kind of observations as noted by Hon'ble High Court.

> "In recent times, we are coming across innumerable cases where the authorities observe with impunity that they cannot follow the decisions of this court on a variety of grounds, such as:
>
> (a) that an appeal was actually filed in the Supreme Court against the judgment of this court and is pending in the Supreme Court.
>
> (b) that a special leave petition is filed in the Supreme Court seeking leave to appeal against the judgment of this Court and the special leave petition is pending in the Supreme Court;
>
> (c) that the Department has not accepted the decision of this Court and is taking steps to file an appeal before the Supreme Court.
>
> We have noticed observations to the above effect in the orders passed by the Commercial Tax Authorities, including the Head of the Department, Commissioner of Commercial Taxes, Income-Tax Officers, including the Head of the Department, the Commissioner of Income-tax, Central Excise and Customs Authorities, including the Collector of Central Excise and Customs and a host of other authorities. The question for consideration is whether the authorities below can refuse to follow the judgments of this court on the above grounds".
>
> …………
>
> "It is clear from the judicial pronouncements above referred to that the authorities and the tribunals functioning within the jurisdiction of this court in respect of whom this court has the power of superintendence under article 227 are bound to follow the decisions of this court unless, on an appeal, the operation of the judgment is suspended. It is not permissible for the authorities and the Tribunals to ignore the decision of this court

> or to refuse to follow the decisions of this court on the pretext that an appeal is filed in the Supreme Court which is pending or that steps are being taken to file an appeal. If any authority or the tribunal refuses to follow any decision of this court on the above grounds, it would be clearly guilty of committing contempt of this court and it liable to be proceeded against".

6.4 The Hon'ble Calcutta High Court considered the issue of hierarchical discipline in the case of *Voest-Alpine Ind. GMBH vs. ITO & Others* (246 ITR 745). In that case the Income Tax Officer while assessing the income of identical nature did not follow the decision rendered by Tribunal in an earlier year in which it was held that the income of the foreign company is not taxable in India. The Hon'ble High Court considered the action of the assessing officer as an act of "Hierarchical indiscipline". The relevant observations made by Hon'ble Calcutta High Court are extracted below:

> "I have gone through the impugned notices as well as the impugned order passed by the Income Tax Officer concerned. I have no manner of doubt that the Income-tax Officer concerned had assessed income-tax on the same income which was fetched from the consultancy services.
>
> I find the specific finding of the learned Tribunal that this income is not taxable and I also find from the finding of the learned Tribunal that the amount which was paid by way of advance tax is liable to be refunded. The learned Tribunal painstakingly considered all the points advanced before him on behalf of the Department.
>
> Since the reference has been refused by the court so also previously by the Tribunal, at the present moment the findings of the learned Tribunal have reached finality. In my view, the venture which has been undertaken by the Incometax Officer for making an assessment is absolutely an act of hierarchical indiscipline. This exercise is nothing short of setting the Tribunal's judgment at naught. It is a well settled principle of law that the junior incumbent is supposed to obey and carry out the order and/or observations made by the superior authority, be it a judicial forum or a quasi-judicial forum or even in any administrative field.
>
> Therefore, I hold that the impugned order passed by the Income-tax Officer is wholly without jurisdiction and the same is liable to be set aside and I hereby do so".

6.5 The Hon'ble Bombay High Court in the case of *Bank of Baroda vs. H.C. Shrivatsava and Another* (256 ITR 385) has also dealt with the impugned issue and the relevant observations are extracted below:

> "At this juncture, we cannot resist observing that the judgment delivered by the Income-tax Tribunal was very much binding on the Assessing Officer. The Assessing Officer was bound to follow the judgments in its true letter and spirit. It was necessary for judicial unit and discipline that all the authorities below the Tribunal must accept as binding the judgments of the Tribunal. The Assessing Officer being an inferior officer vis-à-vis the Tribunal, was bound by the judgment of the Tribunal and the Assessing Officer should not have tried to distinguish the same on untenable grounds. In this behalf, it will not be out of place to mention that "in the hierarchical system of courts" which exists in our country, "it is necessary for each lower tier" including the High Court, "to accept loyally the decisions of the higher tiers". "It is inevitable in a hierarchical system of courts that there are decisions of the supreme Appellate Tribunal which do not attract the unanimous approval of all members of the judiciary. But the judicial system only works if someone is allowed to have the last word, and that last word once spoken is loyally accepted". The better wisdom of the court below must yield to the higher wisdom of the court above as held by the Supreme Court in the matter of Asst. *CCE vs. Dunlop India Ltd* (1985) 154 ITR 172".

7. It appears to be the impression/misunderstanding of some of the tax officials that the orders of ITAT interpreting the law cannot be binding as it is a fact finding authority. However, from the foregoing discussions, one can understand that that the decision of the higher authority in the judicial hierarchy is binding on all the lower authorities below the line. Hence the learned CIT(A) and the assessing officer would be bound by the decision rendered by the jurisdictional Income tax Appellate Tribunal. Refusal to follow the order of the ITAT would render that authority guilty of committing contempt of Tribunal for which the concerned authority is liable to be proceeded against.

8. As held by Hon'ble M.P High Court in the case of in the case Agarwal Warehousing and Leasing Ltd, (Supra), the Learned CIT(A), in the instant case, has committed judicial impropriety and also erred in law in refusing to follow the order of the Appellate Tribunal. Being an authority in the higher hierarchy of the Income tax Department, that too holding appellate charge, the Learned CIT(A), in our view, should not have committed this kind of judicial impropriety.

9. Whenever a decision of the Income tax Appellate Tribunal is found to be unacceptable to the authorities below, the right course to follow is to carry the matter in appeal to the High Court and in case of urgent necessity, to seek suspension of the operation of the order of the Tribunal appealed against. If the Hon'ble High Court suspends the operation of the order appealed against, then the tax authorities are under no obligation to follow the order so suspended till the matter is decided by the Hon'ble High Court.

10. It is not the case that the tax authorities are required to be given guidance on this aspect. In the case of a person occupying the chair of Commissioner of Income tax (Appeals), it is normally expected that he is aware of judicial discipline and also binding nature of the order of the Income tax Appellate Tribunal.

11. However, it is possible that the law of judicial discipline discussed above may be lost sight of by some tax officials. Hence, it would be beneficial to all if the same is brought to the notice of all tax officials in periodic intervals so that this kind of unpleasant happenings can be avoided. Accordingly, we direct the learned CIT (Departmental Representative) to bring this order to the notice of the Chief Commissioner and Central Board of Direct Taxes so that they, being the authorities having superintendence over the tax authorities, may take appropriate steps to enlighten all the officials in order to ensure enforcement of judicial discipline in them, which would avoid considerable harassment, if any, to the assessee public.

12. The assessee has sought appropriate costs in terms of sub-section (2B) of sec. 254 of the Act. However, we notice that the said sub-section was introduced only to discourage filing of frivolous appeals. Hence, in our view, we cannot invoke the said sub-section in the instant case. However, the assessee is free to take proper steps for initiating contempt proceeding against the concerned Learned CIT(A).

13. In the instant cases, the appeals have been preferred by the assessee only because the Learned CIT(A) has rendered his decision without following the decision of this tribunal. It cannot be denied that we would be required to revisit all the issues on which we have already rendered our decision, while it is the duty of the Learned CIT(A) to pass orders in terms of the earlier decision of the ITAT so long as the same is not suspended/reversed by Hon'ble High Court. Hence we deem it proper to set aside all the issues to the file of Learned CIT(A) in order to enable him to pass appropriate orders by duly following the orders passed by the ITAT in the assessee's own case referred (Supra) for other years. Accordingly we set aside the impugned common order of Learned CIT(A) and restore all the issues to his file for adjudicating them afresh by following the decision of ITAT referred supra. Needless to mention, the assessee should be given necessary opportunity of being heard.

14. In the result, all the appeals of the assessee are treated as allowed for statistical purposes.

Pronounced in the open Court on 19th July, 2011.