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This issue contains:

Kind regards

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Appellate Tribunal Inland Revenue
Undesirable changes proposed vide Finance Bill, 2012

by

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The Income Tax Ordinance, 2001 provides for the scheme of levy of income tax, tax administration machinery and mechanisms for redressing taxpayers' grievances. The right of appeal against orders of appellate authorities is also available to the tax administration authorities (for whom it is not uncommon to be aggrieved at relief granted by appellate authorities) for which they could also prefer a higher appellate forum to examine the correctness of relief so given by an appellate authority.

The appellate mechanism under the Income Tax Law is as follows:

- Tax assessment is made by Commissioner or by Taxation Officers working under him through delegated powers.
- In case a taxpayer is aggrieved at the assessment made by the Commissioner, he can appeal to the Commissioner (Appeals)—an officer of the Inland Revenue working under the control of Federal Board of Revenue (FBR).
- In case either of the parties, the taxpayer or the Commissioner, is aggrieved at the decision of the Commissioner (Appeals), the aggrieved party can further file an appeal before the [1]Appellate Tribunal Inland Revenue (ATIR).

Apart from deciding whether or not an assessment is correctly made, the ATIR has powers to decide other matters dealing with exercise of quasi-judicial powers of the tax administration such as, for example, whether or not tax assessment could be reopened by the Taxation Officer and thereby disturb finality of the assessment, whether or not registration as a charitable/non-profitable exemption has been correctly declined by the Commissioner, or whether or not a particular assessment order could be subjected to revision by the Commissioner because of his perception that the order so sought to be revised is erroneous and prejudicial to the interest of the revenue. ATIR is not only an appellate forum for taxpayers, but it is equally important for FBR in case relief is given to the taxpayer by the Commissioner (Appeals), who is incidentally a member of the Inland Revenue Service. The Commissioner can also challenge the order of the Commissioner (Appeals) before the ATIR.

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1 Income-tax Appellate Tribunal' was established on 25th January, 1941. After independence, the name as such was retained by India and Pakistan, except that we changed it to Appellate Tribunal Inland Revenue (ATIR) on 28 October 2009 through a Presidential Ordinance in the wake of amalgamation of income tax and sales tax into one unified group. The Tribunal, that has already completed 71 years of its existence, is considered as mother of all Tribunals. In Pakistan it has permanent seats at Lahore, Islamabad, Peshawar and Karachi.

In developing economies like Pakistan, one of the biggest problems is a relatively small tax base and the reluctance of ordinary people to even file tax returns and thus submit their financial affairs to the scrutiny of the tax administration. Once a taxpayer professes faith in the effectiveness of legal remedies against any unjust tax levy or unjust act of the taxation authorities, he is more likely to be truthful and honest to the taxation authorities accepting a reasonable levy of tax.

The degree of taxpayer satisfaction does, therefore, go up which, in turn, is a sine qua non for better voluntary compliance resulting in greater resource mobilization. While on the surface a tax judiciary inherently deals with involuntary collections enforced by a tax administration, an efficient tax judiciary actually creates a conducive atmosphere for better voluntary compliance by the taxpayer and, thus increased revenue for the State. A tax administration which disposes of appeals promptly and reaches a fair and final settlement speedily is itself entitled to be classified as a tax incentive.

To a tax collector, an efficient tax judiciary ensures that demands arising out of legitimate tax assessments, which can stand scrutiny of law, are not unnecessarily locked up in litigation. As long as there is a pending litigation in relation to a particular tax levy, there is a natural and quite understandable desire on the part of the taxpayer not to pay the disputed amount for the duration of legal proceedings. An efficient tax judiciary resolves the disputes quickly, quashes the demands which are not legally sustainable, and thus segregates serious tax demands from frivolous tax demands, while also giving finality to legitimate tax demands. This in turn ensures that the taxpayer cannot resort to dilatory tactics for paying genuine and legitimate tax demands which have received judicial approval. An efficient tax judiciary thus helps in removing impediments from collection of tax demands by the State which, once again results in greater resource mobilization.

An effective [1] tax judiciary does not only settle tax disputes between taxpayer and the State, but it also lays down guiding principles on the

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1 In the Sub-continent, income tax was introduced by the British colonial rulers in the year 1860, but for its first eight decades of existence, mechanisms for redressing grievances left much to be desired. There was no separation of administrative and appellate functions, and the very Assistant Commissioners and Commissioners, under whose supervision and guidance, tax assessments were made by the Income Tax Officer, were the first and second appellate authority against the order of the Income Tax Officer. There was thus a clear clash of interests between the administrative and appellate functions of the tax authorities. A Commissioner, on one hand, had revenue targets to achieve, and while deciding appeals of the taxpayers, who perceived their tax assessments to be unjust and unfair, on application of the taxpayer, had to refer the points of law for the opinion of the High Court. If the Commissioner so declined to state the case at the request of the taxpayer, the taxpayer could approach the High Court and seek a writ of "mandamus" requiring the Commissioner to state the case. This system of redressing the taxpayers' grievance was not very user friendly as there was no independent adjudication by anyone outside the tax administration on the question of facts, and the costs involved in the legal process, i.e. before High Courts, were very high. This system was perceived to be oppressive and undemocratic. There was so much resentment against this system that the Government had to give in to public pressure and, by Income Tax (Amendment) Act, 1939, bring about two

basis of which such disputes are resolved. These decisions, which have authoritative value in the sense that same decision has to be taken on materially identical facts, also have normative effect and these decisions thus help in correcting judicial courses. This way, an effective tax judiciary also contributes to smooth functioning of the tax machinery.

The setting up of the [1]Tribunal in 1941 brought about a paradigm shift in redressing grievances. The original scheme of things ensured complete functional independence of the institution, a high degree of legal and technical expertise of the Members manning the benches, user friendly, simpler and informal procedures, and an inexpensive and quick justice delivery system. Over the decades, the [2]Tribunal has been strengthened and changes made to cope with the increasing burden of cases and growing complexity of disputes.

Powers of the ATIR are exercised by the benches [section 130 of the Income Tax Ordinance, 2001]. The cases in which amount of tax or penalty does not exceed Rs. one million can be heard by a single member, either a Judicial Member or an Accountant Member. Majority of the cases are heard by division benches comprising one Judicial and one Accountant Member. There is no ceiling on amount of tax involved or income assessed in the cases to be heard by such division benches. Special benches, of three or more Members, of which at least one Member must be a Judicial Member and one Accountant Member, are formed on the issues on which either division benches have expressed conflicting views or on the issues which are of considerable importance. It is thus ensured that the decision of each of the regular or larger bench has benefit of inputs from a Judicial Member as also from an Accountant Member.

The qualification for appointment as Judicial Member is the same as that for the appointment of a High Court judge, and only well experienced and competent people from the legal profession and judiciary are selected.

Prior to amendment in 2007, the Accountant Member must have been an officer of Grade 21. In 2007, the Commissioner in Grade 20 having appellate experience of five years was also included. In 2010, the

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important reforms—first, that judicial and administrative functions of the tax authorities were separated; and—second, an independent body, Income Tax Appellate Tribunal was created to hear appeals against orders of the first appellate authority on all questions of facts and law. That is how Income Tax Appellate Tribunal was set up in the Sub-continent in 1941.

1 The setting-up of the Tribunal in 1941 was welcomed by the public at large. The then Leader of Opposition in the Legislative Assembly, Mr. Bhulabhai J. Desai, welcomed the proposal by stating on the floor of the Assembly as follows:

> **"… with the intervention of such a Tribunal, a substantial step has been gained from the point of view of the taxpayer, that so far as any injustice will be done to him either by misapplication of law or by a wrong finding of facts by the official hierarchy, he will have now redress from an independent body with sufficient legal and accountancy qualifications….."**

2 Incidentally, the Income Tax Tribunal was the first Tribunal set up in the Sub-continent, and it was this successful experiment which resulted in setting up of many more Tribunals.

condition of working as Commissioner Appeal was removed. And now the Finance Bill 2012 has reduced the condition from 5 to 3 years. **The amendments made in 2007, 2010 and the ones proposed in Finance Bill 2012 are highly undesirable. The officer from FBR having little experience or no experience of appellate work should not be part of ATIR**.

In India, accountant members are selected from amongst senior officers of Indian Revenue Service and from amongst chartered accountants having at least 10 years of practical experience in taxation. Thus, every bench has the unique advantage of examining issues from the point of view of a trained legal expert as well as from the perspective of a mature revenue person or CA, who has knowledge and understanding of real life tax and business realities. Normally, one of the Members in the bench is a senior person with reasonable exposure to varied situations to be dealt with in the cases. While, on the factual aspects decision of the Tribunal is final, on substantive questions of law, an appeal can be filed before the High Court. The interference by the High Court and by the Supreme Court, however, is more of an exception than the rule.

The proposal through Finance Bill 2012 to lower the service period requirement for Commissioner to be Member of the Tribunal to three years [section 130(4)(b)] needs to be reconsidered. It will turn Tribunal into 'camp office of FBR'. Junior Commissioners who have never even worked as Commissioner of Appeals would obviously lack the skills to work as Accountant Members. The technical quality of work and understanding of matters required at Tribunal level would be compromised by such appointments.

Amendment proposed in section 130(5) that is deleting the words "and except in special circumstances", is to facilitate an Accountant Member to become the Chairman of ATIR. This is blatantly against the principles of independence of judiciary. A person having lien with FBR (an executive authority) cannot perform the functions of Chairman as it would be violative of Para 5 of the National Judicial Policy 2009 which says:

> **"All special courts/tribunals under the administrative control of Executive must be placed under the control and supervision of the Judiciary, their appointments/postings should be made on the recommendation of the Chief Justices of concerned High Court" [Page 12]**

Thus the original position of law that only a judicial member can be Chairman of the Tribunal should be maintained.

To make Tribunal a truly independent forum, it is even more imperative to provide for recruitment of Chartered Accountants and ICMAs as Accountant Members through FPSC. As far as officers from FBR are concerned, the appropriate rank should be Chief Commissioner or

Commissioner with five years of experience, with at least two years as Commissioner of Appeals.

'Provinces becoming increasingly lethargic in exploiting tax potential'

Owing to higher federal transfers under the current NFC award, the provinces are becoming increasingly lethargic in exploiting the huge tax potential, as all new avenues of tax collection are under provincial jurisdiction, experts said.

"As a matter of fact, the federal government generates 94 percent of the resources in Pakistan, while the contribution of provinces is only six percent," said Naveed Anwar Khan, a senior economist.

The provinces are generally shy of collecting taxes, he said. "Low institutional capacities might be one reason for low revenues generated by the provinces," he said, adding that no efforts were seen in the last two years to enhance the capacities of provincial revenue department.

Sindh took a bold step to establish Sindh Revenue Board that has at least made some progress in increasing the tax collection in Sindh, he said, adding that the Sindh government is on target to increase its sales tax collection from Rs12 billion last year to Rs25 billion by the end of this fiscal year. It had already collected more than Rs20 billion in this regard, he said.

After adding the property tax, vehicle registration fee and other provincial taxes, Sindh generates over 10 percent of its resources from the province, said Khan.

Yunus Kamran, another economist, said that Punjab lags far behind Sindh in provincial tax collection. The provincial tax revenues in Punjab have never exceeded Rs40 billion, he said, adding that out of the expected outlay of Rs750-760 billion of Punjab Budget for 2012/13, the federal transfers alone would provide the province Rs710.297, meaning that the biggest province of the country would have to generate merely Rs40-50 billion to balance the budget.

The past performance of the present Punjab government reveals that its provincial revenues would not exceed Rs40 billion, he said, adding that this would hardly cover five percent of the provincial expenses. In fact, he said, the budget allocation for Punjab police alone is higher than the total revenue collection of the province.

Low generation of provincial resources was the main reason that Punjab grew at a much lower pace of 2.2 percent during the last four years against the growth rate of 3.3 percent attained by the rest of Pakistan.

Asif Ali Shahid, a Canada-based certified public accountant, said that the revenue potential of Punjab lies in agriculture, urban property and sales tax on exempted services.

The government is not prepared to take the risk of imposing general sales tax (GST) on professionals such as doctors, lawyers, engineers, beauticians, and designers, he said, adding that the feudal dominance in the provincial assembly has put an effective bar on levying income tax on agriculture.

A strange anomaly exists as far as tax on rented property is concerned, he said, adding that if a house / office or even vacant urban land is rented there is a property tax on the rent received. However, when an agricultural land is rented to a farmer there is no tax although both the incomes are derived from rent.

Shahid said that urban property tax in Punjab is skewed and is based on the whims of tax collectors. Properties worth billions of rupees in the posh areas are exempted from property tax on the pretext that the properties are built on less than 10 marlas.

The International Resource Centre of London School of Economics and Lahore University of Management Sciences research revealed that property tax in Punjab could be increased manifold if fair and rationale assessment is made. – *Courtesy The News*

‘FBR launched WeBOC system for vested interests’

In order to gain vested interests, the bureaucracy at the Federal Board of Revenue (FBR) launched WeBOC system a year ago, a statement said.

The cost of business is being paid by the importers of the country and because of this semi-automated system, the cost of business has increased to 25 percent, which is not acceptable by the trade community, said Arshad Jamal, senior vice chairman, All Pakistan Customs Agents Association, while addressing a gathering of importers, it said.

The importers have rejected this system because its collectorate has ignored assessment of consignments for evaluation, he said.

Although, there are some issues with PaCCS, but it is an automated solution, he said, adding that the system has the capacity to manage the country’s increasing trade.

WeBOC has no provision to settle consignments without undergoing physical verification of consignments, he said, adding that this condition has not only delayed clearance, but open the doors for corruption.

During the launch, the authorities promised that the clearance of consignments will be categorised in Yellow, Red and Blue, but it failed to introduce the initiative even after one year of operations, which has increased the procedures, the statement said.

The staff at the assessment and examination fixes the speed money for immediate clearance, otherwise the consignments would get further delayed, it said.

Jamal urged the federal minister for finance to investigate the procedures and performance of WeBOC launched a year ago, replacing PaCCS.

Earlier, the revenue body formed a committee to improve reforms, automation and risk management to improve the process of computerisation, automation, risk-management system and monitoring / functioning of WeBOC, but all in vain.

If such uncertain situation prevails, the worries of traders may put the revenue body into trouble, it said.

The computerisation is the backbone of automation and risk management system, but it is disappointed to mention that WeBOC manage several procedures manually.

The FBR should continue PaCCS at all the terminals if it is unable to resolve the issues of WeBOC, the statement said.

The traders said that the importers have never faced such issues in the past when doing business through PaCCS.

The world is moving towards automation, but the authorities in Pakistan rolled back PaCCS for vested interests. – *Courtesy The News*

Airlines seek retrospective relaxation in excise duty

The airline industry has demanded amendment in the federal excise duty (FED) laws for withdrawal of past tax liabilities created by the Federal Board of Revenue (FBR) against one-way tickets sold abroad to travel Pakistan

The Finance Bill, 2012 has proposed an amendment in the Federal Excise Act, 2005, that stated: "Services provided or rendered in respect of travel by air of the passengers embarking on international journey from Pakistan."

The changes has been proposed to be implemented from July 1, 2012, whereas the airline industry is contesting the unlawful demand created by tax authorities on those tickets which were sold outside Pakistan to travel to the country during the period July 2007 to date.

"The finance ministry should further amend the law and allow retrospective relaxation to the airline industry as the exemption given to asset management companies," said an official of the foreign airline asking not to be named.

"There is no question of such payment to FBR as airlines had not deducted FED from passengers travelling to Pakistan," the official added.

However, tax experts said that the tax liabilities created by the FBR against the issue for the period 2007 to 2012 would be automatically withdrawn as provided in section 65 of the Sales Tax Act, 1990, which states: "…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."

Officials in the FBR informed that tax officials had created a demand of Rs4 billion against the airlines on the issue. "The FBR has estimated an amount of about Rs13 billion is involved due to non-compliance by the airlines," an official said.

Previously, the Board of Airline Representatives in Pakistan (BARIP) had approached the finance ministry and informed the collection of FED on one-way tickets sold abroad to travel Pakistan was illegal. The BARIP informed the finance minister that this exercise is against the international law as the sale had no bearing or relevance on the government of Pakistan. The BARIP had also proposed to streamline the rates for all destinations irrespective of SAARC, GCC and European countries.

In the Finance Bill, 2012 the proposal of BARIP incorporated without change and new rates are fixed at Rs3,840 for economy class and economy plus, while Rs6,840 has been fixed for club, business and first class. "This change will generate an additional Rs15 billion for the national exchequer," a source in airline industry said. – *Courtesy The News*

Senate body directs FBR to finalise CGT rules

The Senate's Standing Committee on Finance here on Wednesday directed the Federal Board of Revenue to finalise capital gains tax

(CGT) rules on sale of immoveable property in consultation with all four provinces for uniform valuation of immovable property in the country.

The committee on finance met here under the chairperson Nasreen Jalil to review the Finance Bill 2012-13.

The Ministry of Finance and Federal Board of Revenue (FBR) expressed their inability to accept proposal on reduction in general sales tax (GST) rate from 16 percent to 12 percent saying that this would result in massive revenue loss.

The FBR requested the committee to direct property registrar offices in all four provinces to collect on behalf of the FBR 10 percent CGT on sale of property within one year and 5.0 percent CGT on sale of immovable property within two years after purchase.

The committee decided to recommend the government to impose income tax on income above taxable limit from all sources irrespective of any sectors.

The tax authorities informed the Senate's Standing Committee on Finance that the government will bear a dent of Rs 45 billion if GST rate was reduced from existing 16 percent to 15 percent.

The committee was informed by the officials of the Finance Ministry that major reform in the sale tax for the next fiscal year was to abolish 19.5 percent and 22 rates and now across the board 16 percent sale tax rate has been implemented, this is a major relief.

Finance Secretary Abdul Wajid Rana on the proposal of reducing GST rate from 16 percent to 12 percent said, the reduction in sales tax rate in this massive way would result in massive loss to the national kitty and lead to decrease in share of provinces in the divisible pool, which may not be acceptable to them.

He said that out of the total sales tax collection, provinces' share is 57.5 percents, which would decline in case of reduction in sale tax rate. The secretary was of the view that gradual increase in tax-to-gross domestic product (GDP) ratio would enable the government o reduce the sales tax rate as well as corporate tax rate and immediate 4.0 percent reduction would have considerable impact on the revenue. However, some members of the committee were of the view that increase in tax rate has reduced registration of taxpayers with the FBR.

FBR member Shahid Hussain Asad said that proposed deduction of 1.0 percent withholding tax (WHT) from dealers, wholesaler and retailers by the manufactures is considered very important for the documentation of the economy.

When some senators described deduction of WHT from manufacturers as unfair and unjust, another official of the FBR said that it is not possible for the tax authorities to collect WHT from traders and retailers and this trend of assigning manufacturing as withholdings agent was prevalent even in the developed countries.

The committee recommended that income from all the sources above taxable limit should be taxed and agreed to the proposal of the committee that WHT should be reduced from proposed 1.0 percent to 0.25 percent for unregistered dealers, distributors and retailers who make purchases from registered manufacturers. FBR Inland Revenues member informed that 1.0 percent WHT deduction proposal from unregistered dealers, distributors and retailers is not meant for revenues but for documentation of these undocumented sectors for increase in tax-to-GDP ratio.

He said that those unregistered dealers, distributors and retailers who would be paying 1.0 percent WHT on their purchases would be allowed to adjust this in their final tax liability when they would be filing their income tax returns.

The committee decided that FBR would give a separate presentation to the committee after the budget session by taking on board the State Bank of Pakistan and Ministry of Finance.

The standing committee also proposed unanimously to the FBR for formulation of rules on assessment of value of the asset or immovable property in consultation with all the four provinces for imposition of 10 percent and 5.0 percent CGT to avoid possibility of litigation.

The finance secretary also informed the committee that CGT on sale of immovable property within one or two years would help discourage speculation in real estate sector as well as unjustified increase in prices of properties in the country. He also requested the committee to direct property registrar offices to collect CGT on immoveable property on behalf of FBR.

It was informed that without this collecting mechanism, it would not be possible for the FBR to ensure its collection. The FBR officials also informed the committee that CGT on immovable property would be adjustable against the final income of the taxpayers.

Those taxpayers who would be filing their income tax returns would get this CGT against their final tax liability.

The FBR official informed the committee that the power for valuation of assets is already with the income tax officials; however, the FBR intends to curtail their powers and wants centralised valuation of rules applicable for the entire country.

The committee also recommended increase in import duty on crude palm oil from Rs 8,000 to Rs 9,000 per metric tonne to make this duty equitable for the entire edible oil industry.

Senator Ilyas Bilour informed the committee that only five oil refineries are being benefiting from this incentive and the remaining 300 ghee and cooking oil units are suffering losses from this discriminatory duty structure for a certain lobby.

FBR customs chief also supported the proposal and said that they have no objection on increase in import duty on crude palm oil.

While debating extending tax net on income from all sources, there was hot debate on income from agriculture and it was decided to recommend the government to impose income tax on income above taxable limit from all sources irrespective of any sectors.

Members of the committee rejected the proposal to convert Prime Minister's House to an education institute and said that in all the countries these kinds of residential accommodations are maintained.

FBR Inland Revenues member objected to the proposal to register all the air travellers as income taxpayers and was of the view that people travel for employment, education, business and religious purposes and they all can't be registered as income tax payers. – *Courtesy Daily Times*

No criteria to evaluate property tax in Punjab

The business community as well as the citizens have asked the Punjab government to introduce a proper system for the assessment of property tax in the upcoming provincial budget 2012-13, as the officials responsible for collecting property tax are charging the levy as per their wishes and making money in the absence of a suitable tax collection system.

The traders demanded Punjab Chief Minister Shahbaz Sharif to establish a proper system for the assessment of property tax being collected from land or property holders. They said that presently there is no proper system to measure a property tax, as officials of Excise & Taxation Department are collecting the levy arbitrarily.

Those who offer bribe are being charged a very nominal amount from the officials who declare their property cheaper or inexpensive as per their own wishes. And the share of this money, which amounts to millions of rupees, also goes to high officials including the secretary, they said. “That is why no one can take action or complain against these inspectors, who openly demand bribe from the land holders,” they said.

All Pakistan Anjuman-e-Tajiran president Khalid Perviaz said that Punjab government makes hew and cry against the corruption of federal government, but it never bothers to see the same dishonesty and malpractices by the Excise & Taxation Department officials, who are collecting hundreds of thousands of rupees in a single day by getting commission from the property owners, instead of collecting official tax.

“And who want to pay tax, their property is evaluated so high that he cannot afford to pay original tax and no one is there to take action against these officials or even listen to the complainants,” he added. Muhammad Arshad, a resident of G-Block Gulshan-e-Ravi, owns two properties in Property Tax Zone No9, including residential (293-G) 10-marla and commercial shop No 345C in Jinnah Market, G-Block. He alleged that Excise & Taxation inspector Ghiyasuddin, has imposed very excessive and undue tax on him as a punishment, adding that “I want to pay original tax instead of offering bribe to him”.

He said that the same inspector had imposed the tax for same property as Rs 10,000 each last year. He claimed that he possessed the receipts in this regard. But this year, the inspector is harassing him and his family due to refusal of bribe, imposing the tax up to Rs40,000 for same property. Arshad also wrote a letter on May 19 to Fawad Hassan Fawad, Secretary Excise & Taxation, saying that the assessing authority of the zone is evaluating property tax arbitrarily, having no set pattern or formula.

He demanded the authorities to check the record of tax collection from the area and make a comparison of the levy collected from each land holder of the area, which will clearly indicate that there is no proper assessment system of imposing levy and the officials are free to do wahatever they want. – *Courtesy The Nation*

German Tax Reform For 'Green Growth' Encouraged

A new report from the Organization for Economic Cooperation and Development (OECD) makes numerous recommendations to German decision makers on energy tax reform measures, to limit the amount of carbon, energy and resources Germany uses to grow its economy.

On policies introduced to-date, the OECD commended the stringent environmental requirements now in place, which have caused Germany to become a leader in the environmental goods and services sector. The sector is expected to be worth up to EUR300bn (USD375bn) by 2020 and become an increasingly important source of economic growth and jobs for Germany.

In launching the report on future measures, the OECD's Environment Director, Simon Upton said: “New sources of green growth can play an important part in the recovery from the current economic and financial crisis. In this, Germany is leading the way.”

The report notes that German environmental tax policy dates back to 1999-2003, and could be updated to improve the regime's efficacy. The reform introduced a tax on electricity consumption and gradually increased the excise duties on fossil fuels. Revenues collected have contributed to a reduction in social security contributions, while providing incentives for companies to reduce their carbon footprint.

Estimates indicate that this mechanism has helped reduce energy consumption and greenhouse gas emissions, while having positive employment and economic effects. The OECD points to a number of design features which have, however, reduced the effectiveness of these reforms:

- The eco-tax (i.e. the additional tax applied to the original excise duties) is neither based on the carbon content of fuels nor on other environmental externalities;
- Several tax exemptions, in particular for coal products and export-oriented industrial sectors, have resulted in areas of the economy not being subject to either the eco-tax nor the European Union's Emissions Trading System (EU ETS); and,

- Failure to adjust the tax rates for inflation has reduced their incentive effect. Although energy use has not decreased, failure to adjust tax rates for inflation has resulted in a decline in energy tax revenue. In 2009, this accounted for 2.35% of GDP and 6% of total tax revenue, slightly below the respective OECD Europe averages.

The report says that Germany should ensure that taxes are consistent with the environmental externalities of fuel use. The report notes that in most countries, diesel is taxed at a lower rate than petrol, despite its higher carbon content and the higher levels of local air pollutants it generates. Energy taxation and the EU ETS should be better combined to provide an effective and consistent carbon price signal across the economy, so as to avoid gaps and double regulation between the ETS and non-ETS sectors, the report says.

The report also suggests that Germany's tax regime in respect of vehicles is ineffectively designed. The report says that a patchwork of conflicting economic measures apply to vehicles, and recommends that taxation should be revised to provide a more coherent set of incentives for vehicle owners to purchase and use more environmentally-friendly models.

The report says that Germany's comparatively low tax burden on the purchase of cars provides a relatively weak incentive at present, for the purchase of low-emission vehicles. Furthermore, the OECD has said that the tax treatment of company cars undermines the nation's vehicle tax policies. The report did however commend German policies on heavy goods vehicles, which through the application of emission-based highway tolls, has helped increase the uptake of low-emission freight vehicles. This should be extended to light duty vehicles and passenger cars, the report recommends, to provide similar environmental benefits.

Lastly, the report says that subsidies in place that counteract the impact of energy taxes are significant, amounting to 1.9% of gross domestic product in 2008, representing a considerable loss of revenue for the public budget. The report notes that progress has been made in reducing direct subsidies to coal production and other tax breaks, but warned that remaining support measures may run counter to national climate policy objectives.

The report recommends that Germany should consider establishing a mechanism to systematically screen existing and proposed subsidies against their potential environmental impact, with the goal of phasing out environmentally harmful and inefficient subsidies. Extending the use of market-based instruments, including green taxes, and reforming environmentally harmful subsidies could make the tax system more growth-friendly, would contribute to maintaining a balanced budget, and would help achieve environmental goals more cost-effectively, the report concludes. – *Courtesy tax-news.com*

Netherlands Submits Budget Bill To Lawmakers

Dutch State Secretary for Finance Frans Weekers has recently submitted to the Second Chamber the Act implementing the majority of the fiscal measures contained in the country's 2013 Budget Agreement (UFM).

Following the collapse of Mark Rutte's minority coalition government, a group of parliamentary parties united on the 2013 Budget Agreement on May 25, containing a raft of consolidation and reform initiatives totalling around EUR12.4bn (USD15.5bn) in 2013, designed to strengthen economic growth and to improve the functioning of the housing and labour markets.

The UFM bill provides crucially for a 2% rise in the general rate of value-added tax (VAT) in the Netherlands from October 1, 2012, to 21%. Of the EUR4bn in fiscal revenues expected from the VAT increase, EUR1.5bn will be used next year to strengthen the purchasing power of low-income households in the Netherlands.

In 2014 and 2015, the product of the VAT rise will facilitate a 'tax shift' as it will gradually be channelled back into the country's income and payroll tax system, to boost employment and growth, and to ensure a more robust tax system.

In addition, the bill provides for a permanent reduction in the country's real estate transfer tax, for a rise in alcohol and tobacco duties and for a reduction to 6% in the VAT rate benefiting the arts. The bill also contains a 'green package'.

According to the Dutch finance ministry, the UFM bill raises almost EUR5bn in tax, ensuring an important contribution to sustainable public finances.

The remaining tax initiatives contained in the 2013 Budget Agreement, including plans to double the country's bank tax, will be provided for within the framework of other bills, the ministry adds, noting that the tax provisions pertaining to the reform of the housing market will for example be drawn up within the framework of the 2013 tax plan, due to be presented on budget day.

The 2013 Budget Agreement is designed to reduce the budget deficit to 3% of gross domestic product (GDP) in 2013. – *Courtesy tax-news.com*

Irish Tax Revenues Beat Targets

Irish tax revenues were 2.8% ahead of target for the first five months of the year, with May's total tax revenue up 12.5% on the same period last year.

The latest Irish Exchequer Returns show that, at EUR14.4bn (USD18bn), tax revenues for the first five months of 2012 were EUR386m (2.8%) ahead of target. The performance is described as encouraging by the Finance Department. May's total figure of EUR3.6bn was also up on target by 0.5%, and EUR1.6bn (12.5%) higher than the same period in 2011.

Adjusting for the impact of delayed corporate tax receipts and the reclassification of elements of the pay related social insurance/income tax system, the Finance Department expects to see year-on-year revenue growth of 8.9%.

In the five months to the end of May, three of the 'big four' taxes were ahead of profile. Income tax revenues totaled nearly EUR6bn, up 3.1% on target. Value-added tax (VAT) revenues brought in around EUR5bn, and were 0.7% above target, while corporation tax revenues were worth EUR1.1bn, a figure 17.8% above target. A large number of repayments to companies, previously profiled for earlier months, took place in May, and the Department had expected these to have a negative impact on collection. Excise and stamp taxes were down on target, along with capital acquisitions tax and customs, while capital gains tax was up 4.9% on target.

In May itself, income tax revenues were worth EUR1.0bn, up 2.2% on target. However, VAT, corporate tax and excise were all down on target. VAT revenue came in at nearly EUR1.5bn (down 0.9% on target), corporate tax at EUR592m (down 3% on target) and excise at EUR384m (down 0.3% on target). – *Courtesy tax-news.com*

UK Tax Disputes Surge

The United Kingdom government's aggressive stance against tax avoidance and tax evasion has led to a surge in the number of cases being heard at the tax tribunal, causing a growing backlog of unheard cases.

Ministry of Justice figures show that tax tribunal cases between HM Revenue and Customs (HMRC) and taxpayers have surged from 9,100 new cases in 2010 to 11,000 new cases in 2011. The number of new cases reached a quarterly high of 3,400 in the fourth quarter of 2011.

Accordingly, the backlog of unheard cases has also grown, by about a third, from 16,700 in the fourth quarter of 2010 to 22,100 in the fourth quarter of 2011.

The tribunal system was reformed in 2009 to introduce first-tier and upper-tier tribunals. First-tier tribunals usually hear cases in the first instance, with appeals heard by the upper-tier tribunals.

The increasing number of tribunal cases being heard is indicative of the pressure HMRC has been under to clamp down on tax avoidance and deliver extra revenue for the government during this period of tight public finances, says Pinsent Masons Partner Tax Ian Hyde.

“A more aggressive HMRC inevitably means more disagreements with businesses and individuals over their tax liability,” Hyde observed.”Every new tribunal case is a new business or individual having to spend time, effort, and money to reach an agreement with HMRC. This has a big knock-on effect for the business or individual involved. It sucks up precious time and resources for those in dispute with HMRC and for HMRC too.”

Hyde is also concerned by the ever-rising backlog of cases. “The backlog just goes to show that the system is getting clogged up. There are simply too many cases to handle and something is clearly wrong with HMRC’s approach. True, budget cuts might not have helped HMRC, but they need to adapt more effectively to the situation.”

“To their credit, HMRC have identified some potential changes: they’ve recently softened their Litigation and Settlement Strategy and have put significant energy into Alternative Dispute Resolution including extending a pilot scheme for small businesses,” he continued. “There are therefore more options for a negotiated settlement now. Centrally, HMRC seem to have genuine enthusiasm for change."

"However, it takes more than just a policy change or an announcement to change things on the ground," Hyde cautioned. "The experience for many taxpayers in dispute with HMRC is still one of confrontation rather than consensus. There needs to be a real sea-change in culture at HMRC if a more consensual approach is to be adopted, but turning around the HMRC oil tanker is going to take a lot of time and effort." – *Courtesy tax-news.com*

Italian Public Audit Office Alarmed By High Taxes

In its 2012 Annual Report, the Italian Corte dei Conti, the public audit office, warned that the excessive burden of taxation in the country risked "recessionary tendencies" being produced in the economy, thereby creating the risk of a "downward spiral".

It accepted that the tightening of the economic crisis and the problems in the financial markets during 2011 had led the government, as a priority, to adopt policies to reduce Italy's fiscal deficit. However, it noted that a recessionary "vicious circle" in the economy now needed to be defused.

It underlined that the economic recovery in 2011 had been "asphyxiated" by the "corrective action being concentrated on an increase to tax revenues, from which more than two-thirds of the deficit reduction had been found".

In budgets from the previous Berlusconi government and Monti's 'Save Italy' budget, the fiscal correction was made by way of increased taxation – 82% in 2012, 70% in 2013 and more than 65% in 2014. The total amount of the tax burden was thereby increased to 42.5% of total incomes last year, and will rise to more than 45% for each of the succeeding three years.

The Corte dei Conti is the latest in a long line of leading commentators to express alarm at the effect of the measures taken to reduce Italy's fiscal deficit on the possibility of growth in the economy. The tax burden levels placed on employers and employees way beyond the European average is said to be generating the conditions for further recessionary effects.

The solution proposed by the Corte dei Conte would be an intensification of the campaign against tax evasion to provide the funds necessary for re-establishing equilibrium in the Italian tax system. "The case is strengthened," its President, Luigi

Giampaolino argued, "for a solution to be found in widening the tax base, allocating to the actions being taken against tax evasion the task of ensuring the resources for that purpose."

In its report, the Corte dei Conte re-emphasized that, "even if tax evasion is currently being reduced, tax evasion remains a heavy burden on the tax system and the Italian economy". It pointed out that the hole in the public finances from 2007 to 2009 deriving from unpaid value-added tax (VAT) and the regional tax on production (IRAP) reached more than EUR46bn (USD57.5bn). The level of evasion of VAT and IRAP has been put at 29.3% and 19.4%, respectively.

However, the government, in an immediate reply from the Minister for Parliamentary Relations, Piero Giarda, made it known that there were, at present, few possibilities for a reduction in taxation. The government, he said, still retains hopes of lessening tax burdens, but the current international economic and financial conditions present an ever-increasing difficulty, as do the recent earthquakes where funds will be necessary for reconstruction and rehabilitation. – *Courtesy tax-news.com*

Tax on consumption of above 1,000 units of power/month proposed

Federal Board of Revenue (FBR) Member Inland Revenue Shahid Hussain Asad on Wednesday floated a new proposal to generate additional revenue from the rich persons by collecting some extra income tax on consumption of above 1,000 units of electricity on monthly basis.

During the second day of the review of the Finance Bill (2012-2013) the Senate Standing Committee on Finance at Parliament House, top tax manager requested the Senators to consider the proposal for charging extra income tax from persons, who can afford to use air conditioners and consuming electricity above 1,000 units per month. The parliamentarians should consider imposition of extra income tax on elite class which can afford to use air conditioners on regular basis. These persons have the capacity to make expenditure on paying huge amount of utility bills and the same would not face any problem in payment of some extra amount of income tax. The proposal is to impose additional income tax on the consumers of electricity above 1,000 units per month. Such consumers would mostly cover rich persons having air conditioners at their residential places and have the capacity to pay.

Showing full commitment to bring rich persons into the tax net, FBR Member IR was confident that the additional amount of income tax should only be applicable on rich persons who are already spending huge amount on utilisation of air conditioners. These persons can afford expenditure on electricity. “The persons who can spend more should also pay more taxes. We have to take some measures to generate additional revenue from the persons making huge expenditure but paying meager amount of taxes,” he added.

Few senators were of the view that it would not be appropriate to impose additional income tax on consumption of over 1,000 unit power per month due to election year. The new or additional taxation cannot be done during the election year, they added.

Giving rationale behind the proposal, Shahid Hussain Asad insisted that the senators should consider such taxation measure for generating additional revenue from the rich people. If the FBR propose imposition of Special Excise Duty or additional Federal Excise Duty on the air conditioners, it would be a one-time levy and would not serve the purpose. The intention is to impose additional tax on monthly basis from the consumers of air conditioners having the capacity to pay higher amount of tax. In case of Special Excise Duty or additional Federal Excise Duty on the air conditioners, it would not serve the purpose of regular collection of additional taxes from the elite class.

When we talk about tax gap of Rs 500 billion, there is a need to collect more taxes from those making huge amount of expenditures. The persons have the capacity to make expenditures must be subjected to higher rate of taxes, FBR Member IR said.

Shahid Hussain Asad further proposed that the government should have the right to purchase assets on payment of additional amount of 10 percent over and above the declared amount of assets. If a person has declared a specified value of an asset, the government should have the first right of purchase such assets from the owner.

To a question on the abolition of the Universal Self-Assessment Scheme (USAS), FBR Member IR said that all modern tax administrations have adopted the system of the USAS to end interaction between the tax collectors and taxpayers. The USAS is backed by audit of selected percentage of the cases as deterrence.

We have to move towards documentation so that the people should not have any room for concealment of income. If the salaried class is paying the due amount of taxes, it is only due to the accurate system of the deduction of tax from the salaried class. If the same kind of tax deduction procedure has been placed for business individuals, the concealment of income could be checked by other categories of taxpayers. – *Courtesy Business Recorder*

FBR presents legal viewpoint

Federal Board of Revenue (FBR), Member Legal Muhammad Aqil Usmam on Wednesday submitted legal viewpoint of the Law and Justice Division on the imposition of the capital gain tax (CGT) on immovable property before the Senate Standing Committee on Finance, paving way for the FBR to collect the CGT on sale of property after amendment in entry No 50 of the Federal Legislative List through the Constitution Eighteenth Amendment Act, 2010.

Aqil Usman having ample experience of interpretation of tax laws explained the Senate Standing Committee on Finance about the legal opinion of the Law and Justice Division. The Law Division has confirmed the interpretation made by FBR Member Legal on the amendment to entry No 50 of the Federal Legislative List under the Constitution Eighteenth Amendment Act, 2010.

The legal viewpoint of the Law and Justice Division said that the following question has been referred for advice of this Division by the FBR: "Whether after the amendment in item No 50 of the Federal Legislative List through Eighteenth Amendment (Act, 2010) in the Constitution, the levy of tax on capital gain on the disposal of immovable property has become federal subject and now the Majlis-e-Shoora (Parliament) can legislate for the levy of tax on capital gain on disposal of immovable property?".

Law Division ruled, "After amendment in entry No 50 of the Federal Legislative List through the Constitution Eighteenth Amendment Act, 2010, the levy of tax on capital gain on the disposal of immovable property has fallen within the domain of the Parliament to legislate on the subject.

The query raised is answered accordingly", Law Division added. FBR Member Legal informed the committee that prior to the amendment in item No 50 of the Federal legislative list of Schedule Four to the Constitution of 1973 through Eighteenth

Amendment (Act of 2010) the Majlis-e-Shoora (Parliament) had no power to legislate for the levy of tax on capital gain on disposal of immovable property.

Accordingly in section 37 of the Income Tax Ordinance, 2001, which lays down the procedure for taxation of “capital/gain”, the expression 'any immovable property' was consciously excluded from the purview of meaning of “capital assets” provided in sub-section (5) of the said section. Through Eighteenth Amendment in the Constitution of Islamic Republic of Pakistan, 1973, item No 50 of the Federal Legislative List has been amended as under: “50 Taxes on the capital value of the assets, not including taxes” [ ] on immovable property.

--- The words “on capital gain: omitted ibid.” After this change in the Federal Legislative List, the Board is of the view that now levy of tax on the income under the head capital gain on disposal of immovable property has become federal subject and the Majlis-e-Shoora (Parliament) can legislate for the levy of tax on the income under the head capital gain on disposal of immovable property, FBR Member Legal said. Keeping in view the above said amendment in the Federal Legislative List there is a proposal for levy of tax on the income under the head capital gain on disposal of immovable property in the budget. – *Courtesy Business Recorder*

Government urged to bring agriculture sector into tax net

The Senate Standing Committee on Finance on Wednesday proposed to the government for taking concrete measures to bring into tax net all incomes above the taxable limit, including income from agriculture sector to broaden the tax base for resource mobilisation.

This was the consensus of senators across the political divide. Several proposals were suggested to the officials of Finance Ministry and Federal Board of Revenue in this regard. The meeting, presided over by Chairperson Nasreen Jalil of the Muttahida Quami Movement (MQM), was held to review the Finance Bill 2012-13. The committee members said that low tax-to-GDP ratio was a major reason for prevailing economic problems and urged the tax authorities to bring all incomes above taxable limit into the tax net irrespective of source. Secretary Finance Abdul Wajid Rana, in response to a proposal of Senator Haji Adeel for reduction in sale tax rate to 12 percent, said that such a massive reduction in would not only reduce revenue but would also lead to a decline in shares of provinces from the divisible pool.

The Secretary Finance said that as a major reform in the sale tax system, the government abolished rates of 19.5% and 22% from the next fiscal year to implement a uniform rate of 16% sale tax on all items. Wajid Rana said that 57.5 per cent sale tax collection was going to the provinces from the divisible pool and a reduction in the provincial share would not be acceptable to the provinces.

He said that the government was not in a position to lower GST rate because of resource constraints. He said that a gradual increase in tax-to GDP ratio would enable the government to make a cut in the GST rate as a reduction of 4% in one go would have a considerable impact on revenue and deficit.

Senators, including Ilyas Balour, argued that an increase in sale tax rate discouraged taxpayer registration and their claim was neither challenged by the FBR or by the Finance Ministry. On the issue of CGT on immovable property transactions, the Finance Secretary's stated that the tax would be instrumental within one or two years in discouraging speculation in the real estate sector. He said that it would also discourage unjustified price increase of properties and sought help from the committee in this regard and wanted property registrar's offices to collect CGT on immoveable property on behalf of the FBR.

The committee also recommended increase in import duty on crude palm oil from Rs 8,000 to Rs 9,000 per metric ton to make this duty equitable for the entire edible oil industry. Senator Ilyas Bilour informed the committee that only five oil refineries were benefiting from this incentive and the remaining 300 ghee and cooking oil units were suffering losses because of this lobby-specific discriminatory duty structure. – *Courtesy Business Recorder*

FBR ready could reduce ST, corporate income tax rates

Federal Board of Revenue (FBR) Member Inland Revenue Shahid Hussain Asad has said that the Federal Board of Revenue (FBR) is ready to bring down rates of sales tax and corporate income tax following broadening of the tax-base and documentation of economy which would be instrumental in generating additional revenue.

FBR Member Inland Revenue informed the Senate Standing Committee on Finance here on Wednesday, if the government achieves the desirable results of the broadening of the tax-base, the FBR can reduce the sales tax rate to facilitate the business and trade. He said that at present the FBR will suffer massive revenue loss of Rs 40-45 billion in case the standard rate of the sales tax has been brought down from 16 to 15-14 percent. The government will bear a dint of Rs 40-45 billion if General Sales Tax (GST) rate reduced from existing 16 percent to 15 percent or below.

Responding to a query, FBR Member IR stated that if the government has political will, the tax machinery can successfully document the economy with political backing of the Parliament. If we are able to document the economy, both the rates of sales tax and income tax would be slashed in future. However, there would only be two taxes in future ie sales tax and income tax. The government is gradually phasing out the federal excise duty and the FED would be complexly eliminated in the next 2-3 fiscals.

While debating extending tax net on income from all sources, there was hot debate on income from agriculture and it was decided to recommend the government to impose tax on income above taxable limit from all sources irrespective of any sectors. Member Inland Revenues objected the proposal to register all the air travellers as income taxpayers with the argument that people travel for employment, education, business and religious purposes and they all cannot be registered as income taxpayers. – *Courtesy Business Recorder*

No. NBFCD/CIRCULAR/2012-133 Islamabad, the 8th May, 2012

SECP CIRCULAR NO. 15/2012

Subject: **Minimum Requirements for Exchange Traded Funds to be managed by AMCs.**

In order to facilitate the launch of Exchange Traded Funds (ETFs) in Pakistan, the Securities and Exchange Commission of Pakistan ("the Commission"), in addition to the requirements as laid down in the Non-Banking Finance Companies (Establishment and Regulation) Rules, 2003 (the "NBFC Rules") and the Non-Banking Finance Companies & Notified Entities Regulations, 2008 (the "NBFC Regulations"), has decided to introduce a framework for regulation of Index Tracking Exchange Traded Funds.

Therefore, in exercise of the powers conferred under section 282B (3) of the Companies Ordinance, 1984, read with the NBFC Regulations, 2008 the Commission hereby prescribes the following minimum requirements for Index Tracking ETFs.

The requirements for ETFs encompass the following aspects:

I. Eligibility
II. Definitions
III. Name of Scheme and Acceptability of Index
IV. Investment Restrictions
V. Issuance and Redemption of Creation units
VI. Pricing and Dealing
VII. Authorized Participants
VIII. Dealing of ETF units on the Stock Exchange
IX. Dissemination of Information
X. Fee and Expenses
XI. Non applicability of Regulation 41(k), 57 and 58(1)(1) of the NBFC Regulations

I. ELIGIBILITY

A Non-Banking Finance Company licensed by the Commission to provide Asset Management Services, i.e. Asset Management Company (AMC) is eligible to launch index tracking ETFs. An AMC shall ensure that in addition to the provisions of the NBFC Rules and the NBFC Regulations pertaining to Collective Investment Schemes that are not otherwise modified, relaxed or waived, an ETF complies with all the requirements specified hereunder.

II. DEFINITIONS

a) **Authorized Participant ("AP")** means the market maker as defined in the Stock Exchanges Regulations, and who is appointed by an AMC under the Authorized Participant Agreement.

b) **Authorized Participant Agreement ("APA")** means an agreement entered into between the AP, 'trustee and the ANIC setting out the roles and responsibilities of each party and includes, among other things, the terms and procedures to be adopted by the AMC & AP for the issuance and redemption of Creation units. Minimum contents of the APA are specified in Annexure A.

c) **Benchmark Index** means the Index approved by the Commission, is specified in the Constitutive Documents of the ETF (the "Constitutive Documents") and against which the performance of ETF is measured.

d) **Cash component** means the difference between the applicable Net Asset Value (NAV) of a creation unit and the market value of the Portfolio Deposit. The Cash component will represent accrued dividend, accrued annual charges including management fees and residual cash in the scheme.

e) **Creation unit means** the specified number of ETF units for issuance or redemption as determined by the AMC and disclosed in the Constitutive Documents.

f) **ETF** means Exchange-Traded Fund, which is a listed index-tracking open end fund structured as a Collective Investment Scheme. The primary objective of the ETF is to mimic the return of a particular benchmark index by investing substantially all of its assets in the constituent securities of the benchmark index. ETF shall issue and redeem Creation units in-kind through APs only.

g) **ETF unit** is a unit of open end scheme that tracks a benchmark index and is listed on the stock exchange and may he bought and sold like any other share on the stock exchange.

h) **INAV** means Intra-day Net Asset Value calculated on a current basis (with regular intervals) after incorporating the price change of underlying securities throughout a business day. INAV is indicative current basis Net Asset Value of an ETF unit that facilitates trading of ETF in the secondary market.

i) **In-kind Creation** means a portfolio of securities and the cash component to be delivered to the AMC, by an AP either on its own account or on behalf of its clients for creation of FTF units.

j) **Portfolio Deposit** means a pre-defined basket of securities that represents the benchmark index together with a cash payment (if applicable) for the purposes of issuance and redemption of Creation units and will be announced by the AMC, and composition of the Portfolio Deposit may change from time to time.

k) **Tracking Error** means the difference between daily returns of an ETF and that of the underlying Benchmark Index for any given period.

Terms not defined here shall have the same meaning as assigned in the NBFC Rules, the NBFC Regulations, and Regulations of the Stock Exchanges.

III. NAME OF SCHEME AND ACCEPTABILITY OF INDEX

1. AMC shall ensure that in addition to compliance with the minimum disclosure in the Offering Document of a Collective Investment Scheme prescribed under the Regulations, it complies with the additional disclosure requirements in the Offering Document of an ETF, as specified in Annexure B to this Circular.
2. AMC shall ensure that name of the scheme appropriately reflects the nature of an ETF, i.e. the name of the ETF shall clearly specify the benchmark index it aims to track and `index tracking' shall be appropriately stated in the name of the scheme.
3. The acceptability of a benchmark index which is to be tracked by an ETF shall be assessed on the basis of the following criteria:

   It shall:

   a) have a clearly defined objective;

   b) be investible;

   c) appropriately reflect the characteristics of the relevant market or sector;

   d) be able to fairly reflect price movements of its component securities, and change the composition and weightings of the component securities;

   e) be broadly based and be sufficiently liquid with no one component security constituting more than 20% of the total value of the ETF. However, such limit on an individual scrip shall not apply in case of well recognized indices;

   f) be transparent, shall conveniently be accessible by investors and published in an appropriate manner; and

   g) be based on securities listed and traded on a stock exchange in Pakistan.

Furthermore, the Commission may require an independent review of the proposed index by the Exchange or any other third party, to assess the criteria stated above.

4. AMC shall ensure that the underlying index to be tracked by the ETF shall fulfill all the eligibility requirements as stated in clause 3 above.
5. The Commission may withdraw registration of an ETF if its index no longer complies with the requirements of above stated clause 3.
6. AMC shall immediately notify the Commission, the stock exchange on which the ETF is listed and the underlying unit holders of the ETF in case of any event that may adversely affect the acceptability of the benchmark index in accordance with the above stated clause 3 and such adverse events include but are not limited to a change in the:
   a) basis of composition or calculation of the benchmark index;
   b) objective or characteristics of the benchmark index;
   c) composition of the benchmark index such as, due to inclusion or deletion of any security; or
   d) weightage of the benchmark index constituents such as due to corporate activities (e.g. mergers and acquisitions) or significant market movements.

IV. INVESTMENT RESTRICTIONS IN AN ETF

7. AMC shall ensure that the weightage of the component securities in the ETF are based on the entire component securities (full replication) of the benchmark index except where the ETF is unable to fully replicate the benchmark index due to market limitations, deviation of up to 15% is acceptable provided that such parameters and features are defined in detail in the Constitutive Documents. The Commission under special cases may allow partial replication of an index by an ETF subject to compliance with clause 3 above.
8. AMC shall ensure that at all times, at least 85% of the assets of the ETF remain invested in the component securities of the benchmark index being tracked by it, while the remaining assets may comprise of cash or cash equivalents.
9. AMC shall ensure that per party, per group and sector exposure limits and restrictions in relation to the securities held by the ETF are in accordance with their weightage in the benchmark index. Any non-compliance or breach of such investment limits shall be rectified within 3 business days.
10. AMC, to ensure proper and efficient management of the ETF, shall define in the Constitutive Documents, the parameters for

the level of cash and cash equivalents to be maintained by the ETF.

V. <u>ISSUANCE AND REDEMPTION OF CREATION UNITS</u>

11. AMC shall ensure that:

    a) APA sufficiently covers details of the procedures to be adopted by the AMC, AP and Trustee for issuance and redemption of Creation units and shall submit copy of the same to the Commission for its record; and

    b) All requests for issuance and redemption of Creation units are originated or routed through the AP only.

12. AMC may change the Creation Unit size of an ETF only if permitted by the Constitutive Documents and shall be subject to the prior approval of the trustee and the Commission. Any change approved in the Creation Unit size shall be intimated by the AMC in writing to the stock exchange where the ETF is listed at least 3 working days prior to the effective date of such change.

13. AMC shall ensure that the expenses and other charges are adequately disclosed in the Constitutive Documents and an estimate of the expenses and other charges shall be reviewed regularly and revised, if necessary.

14. AMC shall ensure that all provisions and procedures relating to issuance and redemption of Creation units are adequately and clearly disclosed in the Constitutive Documents.

15. The Trustee of an ETF shall issue or redeem Creation units only upon the instructions of AMC subject to compliance with the procedures specified in the NBFC Rules, the NBFC Regulations, the APA and the Constitutive Documents.

16. The Trustee of an ETF shall ensure issuance of Creation units upon completion of transfer of title of the portfolio deposit and cash component in the name of the ETF.

VI. <u>PRICING AND DEALING</u>

17. AMC shall issue or redeem Creation units only at the NAV calculated in accordance with the Constitutive Documents.

18. AMC shall ensure that the issuance and redemption of Creation units with AP are priced on the basis of NAV of the ETF. However, the unit of the ETF shall trade on the stock exchange on the basis of the market price.

19. AMC shall ensure that the INAV per unit and the end of day NAV per unit are calculated on the basis of a process and criteria which is consistently applied by the AMC or the third-party to whom this function is delegated to ensure that the valuations are objective and independently verifiable.

20. AMC shall carry out determination of the INAV per unit on a current (with regular interval) basis, within a business day as deemed necessary by the AMC and as specified in the Constitutive Documents. The AMC shall ensure that INAV is disseminated to the stock exchange on which the ETF is listed on a current basis (with regular interval) and as per the disclosures made in the Constitutive Documents.
21. AMC may delegate calculation of INAV to an independent third-party subsequent to ensuring that the said party possesses requisite financial, human and technological resources available to perform the delegated function satisfactorily. Notwithstanding delegation of this function to an independent party, an AMC shall be fully responsible for proper calculation and timely dissemination of INAV on the basis disclosed in the Constitutive Documents.
22. The Trustee of an ETF shall ensure that issuance and redemption of Creation units is done on historic pricing basis and any transfer of underlying securities into and out of the ETF is also based on the valuation used in determining the ETF's NAV.

VII. <u>AUTHORIZED PARTICIPANTS</u>

23. AMC shall ensure that the AP has sufficient resources and capabilities to satisfactorily fulfill its role and obligations and comply with the requirements on an ongoing basis.
24. AMC shall ensure that the ETF has at least one AP at all times who shall be appointed by the AMC for the purpose of In-kind issuance and En-kind redemption of Creation units with ETF under the APA and for active market making in ETF units,

VIII. <u>DEALING OF ETF UNITS ON THE STOCK EXCHANGE</u>

25. AMC shall ensure that an ETF complies with the listing requirements and any other regulations of the stock exchange on which it is listed on an ongoing basis.
26. In the event trading in ETF units is suspended, AMC shall ensure that before resumption of trading of such ETF units, it notifies the Commission in writing of the effective date of the proposed resumption.
27. The trustee of an ETF shall not process or facilitate any request for issuance or redemption of Creation Units during the period of suspension of trading in ETF units on the stock exchange.
28. Trading in ETF units on the exchange may continue during the period of suspension of issuance and redemption of ETF units.
29. AMC shall ensure that in the event it requests for de-listing of an ETF, it shall immediately inform the Commission in writing

stating its reasons, rationale and circumstances for such delisting.

IX. DISSEMINATION OF INFORMATION

30. AMC shall ensure that information as stated below is disseminated to the public on regular and timely basis:

a) AMC or third party on behalf of an AMC shall disclose the following information regarding ETF:

Components	Frequency	Measured
ETF Market Price	Real Time	Per unit
INAV	Current with regular interval	Per unit
Net Asset Value	Last day	Per unit
Units Outstanding	Last day	No of units
Accumulated Dividend	Last day	Per unit
Total Cash Component	Last day	Per creation unit
Benchmark Index	Real time	–

b) AMC shall disclose in respect of an ETF the details including portfolio deposit, cash component and the number of units outstanding, on a daily basis to the Exchange on which the ETF is listed.

31. AMC may use other acceptable channels or modes of communication for dissemination of information relating to the ETF and the said modes may include:

a) hyperlink to the website of the exchange or the AMC's own website;

b) pages made available by information vendors to disseminate trading information of the ETF units in their ordinary course of business and which are easy accessible by retail investors/ general public;

c) electronic medium for information dissemination as provided by the exchange from time to time; or

d) any other channel considered acceptable by the Commission.

32. The Commission may from time to time require additional information to be disclosed on a real-time or any other basis, as it may deem necessary.

X. FEES AND EXPENSES OF ETF

33. AMC may charge to the ETF only those expenses that are directly related to and necessary for managing the operations of

the ETF including Index license fee, maintenance or independent verification fee of an Index by a third party.

34. AMC shall ensure that all expenses chargeable to the ETF are properly and clearly disclosed in the Constitutive Documents.

XI. NON-APPLICABILITY OF REGULATION 41(K), 57 AND 58(1)(1) OF THE NBFC REGULATIONS

35. The following requirements of the NBFC Regulations shall not apply in the case of an ETF:

    a) The requirement under paragraph 41(k) of the NBFC Regulations, whereby trustee shall ensure issuance of units after realization of subscription money provided that the trustee has received the underlying securities and cash component;

    b) The requirements and procedures for open-end schemes as specified under Regulation 57, except for sub-regulation (1) of the said Regulation; and

    c) The prohibition under Regulation 58(1)(1), from issuance of units for consideration other than cash, in case of in-kind issuance of Creation units of a ETF.

36. The Commission may, from time to time, specify additional requirements or such other conditions as it may deem fit.

Annexure A

MINIMUM CONTENTS TO BE COVERED IN AUTHORIZED PARTICIPANT (AP) AGREEMENT

AP agrees to act as a market maker of the Fund (the ETF) and the Asset Management Company (AMC) authorizes AP to create and redeem units of the fund in Creation Unit size or multiple thereof.

Both parties mutually agree to clauses relating to the following areas:

(i) Adherence to Constitutive Documents, applicable Rules, Regulations, Laws and other procedures devised by AMC from time to time;

(ii) Relationship and Role of each party to the agreement;

(iii) Procedure for Creation and Redemption of units;

(iv) Procedure for settlement of Cash Component;

(v) Conditions where Bids and Offers can be withdrawn by AP (such as at upper & lower caps);

(vi) Fees (if any), and disclosure on charging of fee;

(vii) Notification to AP by AMC for changes in index weights and composition;

(viii) Indemnification from AP to AMC to cover AMC for areas where AMC cannot regulate the AP);

(ix) Availability of Information;

(x) Standard format of notices and procedure to be exchanged between the parties;

(xi) Procedure for making amendments to the Agreement;

(xii) Effectiveness, Termination of Agreement and Dispute Resolution;

(xiii) Governing Laws;

(xiv) Definitions (other than those covered in the NBFC Regulations and this Circular); and

(xv) Signatories to the Agreement and Witnesses.

Annexure B

MINIMUM ADDITIONAL INFORMATION TO BE DISCLOSED IN OFFERING DOCUMENT OF ETF

AMCs shall ensure that the following disclosures are made in the offering document of an ETF in addition to the areas specified in Schedule VIII of the Regulations.

INTRODUCTION TO ETF

(i) Description of ETF highlighting the basic features;

(ii) Advantages and disadvantages of ETF;

(iii) Difference between ETF and other Open ended Funds;

(iv) Parties to an ETF; and

(v) Description of how an ETF works through a flow chart.

AUTHORIZED PARTICIPANT

(vi) Role, Duties and Responsibilities of Authorized Participants;

(vii) Names and Contact information of Authorized Participants; and

(viii) Salient features of Authorized Participant Agreement.

BENCHMARK INDEX

(ix) Profile of Benchmark Index;

(x) Constituent of Benchmark Index;

(xi) Circumstances under which Benchmark Index of ETF may change;

(xii) Disclosure of Risk Factors related to Benchmark Index;

(xiii) Constituents of Benchmark Index and weightings of the top 10 largest constituent securities (where applicable) of the benchmark index as of a date within a month of the date of the offering document;

(xiv) Frequency with which benchmark index composition is reviewed;

(xv) Means by which investors may obtain the latest benchmark index information and other important news of the index; and

(xvi) Target tracking error.

OFFER/REDEMPTION OF UNITS

(xvii) Offer of units during Pre-Listing phase (Initial Offer);

(xviii) Offer of units in Post-Listing phase;

(xix) Procedure of In Kind Creation;

(x) Procedure of In-Kind Redemption; including monetary and time cost to the investor, and policy for partial shares;

(xxi) Procedure of Trading of ETF units on exchange;

(xxii) Timeline for issuance and redemption of Creation Units; and

(xxiii) Frequency and Notification of change in Portfolio Deposit.

INAV

(xxiv) Calculation Methodology of INAV;

(xxv) Mode and frequency of dissemination of INAV; and

(xxvi) Entity responsible for transmitting INAV.

WARNINGS/RISKS

(xxvii) Where necessary, a statement to the effect that the investment of the scheme may be concentrated in the securities of a single issuer or several issuers;

(xxviii) A statement to the effect that there is no guarantee or assurance of exact or identical replication at any time of the performance of the benchmark index;

(xxix) Circumstances that may lead to tracking errors and the related risks, and strategies employed in minimizing such errors;

(xxx) A warning that benchmark index composition may change and underlying securities may be delisted;

(xxxi) A warning in relation to any licensing conditions (including indemnity given to the index provider, if any) for using the benchmark index, and the contingency plan in the event of cessation of the availability of the benchmark index;

(xxxii) A warning of lack of discretion to adapt to market changes due to the inherent investment nature of index funds and that falls in the benchmark index are expected to result in corresponding falls in the value of the ETF;

(xxxiii) A statement on whether the index provider and the AMC of the scheme (or its connected persons) are independent of each other. If not, the means by which possible conflicts of interests may be addressed; and

(xxxiv) any other information which is relevant and material for investors to make an informed investment decision.

No. SC/M/CIRCULAR/R.B/2012-208 Islamabad, the 31st May, 2012

SECP CIRCULAR NO. 16/2012

The Modarabas extend *Ijarah* financing facility to the clients on the basis of *Ijarah* Agreement duly approved by the Religious Board. However, some times Ijarah assets are not readily available and the Modarabas have to make advance payment to supplier/manufacturer of the said assets without any legal agreement with the client, as *Shari'ah* does not allow execution of "*Ijarah* Agreement" with the customer in the absence of physical existence of the assets. This situation exposes the Lessor (Modaraba) to the risk of refusal from the client at the time of actual delivery of the assets.

2. In order to overcome the aforementioned practical difficulty, one of the Modarabas had submitted the "Letter of Agreement to *Ijarah*" ("the Letter") as a risk management tool from the customers to ethically bind them to take the assets on *Ijarah* basis on the date of delivery. The Letter was submitted to the Religious Board for necessary certification and approval that the same is not in conflict of Shari 'ah principles. The Religious Board in its 37th Meeting held on April 20, 2012, considered the Letter and approved the same unanimously. A copy of the Letter duly approved by the Religious Board is enclosed herewith. It is expected that the Letter would facilitate Modarabas in undertaking *Ijarah* transaction and work as a risk mitigating tool for the *Ijarah* transactions to be undertaken by Modarabas with their clients.

LETTER OF AGREEMENT TO IJARAH

Date:

The Manager

_________________Modaraba

____

____

Dear Sir,

I/We refer to your offer letter dated__________to________(name of Modaraba), Address:____ for acquiring Asset___________(hereinafter referred to as "_________ Modaraba" which expression shall be deemed to mean and include where the context so requires its successors in interest and assigns) whereby I/we requested ___________ Modaraba to Ijarah to me/us the Asset(s) _____________ to be acquired by__________Modaraba for this purpose.

1. Whereas __________ Modaraba has agreed to acquire the specified Asset(s) ("Asset(s)" to be subsequently taken on Ijarah to me/us as per the terms of the Ijarah agreement to be executed between __________ Modaraba and ourselves (Ijarah agreement the cost of the Asset(s) paid / to be paid by __________ Modaraba in respect of its acquisitions shall be Rs. ____________/- (Rupees Only).
2. And whereas, I/we have agreed to take on Ijarah the Asset(s) to be acquired upon the terms and conditions set forth as follows:

NOW THEREFORE THIS LETTER WITNESSES AS FOLLOWS:

1. Ijarah of Asset(s)

In consideration of _____________ Modaraba, acquiring the Asset(s) at my/our request for the purposes of making available the Asset(s)to me/us by way of a Ijarah, I/we hereby agreed and irrevocably agree to take on Ijarah the Asset(s) from _____________ Modaraba on the date mentioned in appendix "A" hereto or on such other date as the Asset(s) are delivered to me/us ("Ijarah Date") by execution of the Ijarah Agreement and its ancillary Ijarah Documents in the form required by _________ Modaraba.

2. Payment of Advance Against Ijarah Rentals

2.1 I/We agree to pay to __________ Modaraba advance against Ijarah rentals, if __________ Modaraba demands, in the amount and on the dates mentioned in appendix "B" hereunder (Advance Ijarah Rentals"). Upon commencement of the Ijarah Agreement the amount received by way of Advance Ijarah Rentals shall be adjusted as Ijarah rentals due and payable under the Ijarah agreement after confirmation of the delivery of the asset.

2.2 In case the Ijarah does not commence due to any reason whatsoever on my side or due to any negligence on my side the Advance Ijarah Rentals shall be refunded to me/us after deduction of all dues/cost incurred by lessor in acquiring the asset(s) and any other outstanding of __________ Modaraba hereunder or otherwise in relation to the provision of the Ijarah finance facility.

2.3 In case the Ijarah does not commence due to any reason whatsoever on the side of Lessor or due to the negligence of the Lessor the Advance against Ijarah Rentals shall be refunded to me in full without any deduction.

3. Act of Default

3.1 There shall be an act of default (Act of Default on my part") hereunder if:

3.1.1 I/we fail to take on Ijarah Asset(s) at the time of delivery by Lessor as specified under clause -1, herein above for any reason whatsoever.

3.1.2 Any representation or warranty made or deemed to be made hereunder is or proved to have been incorrect in any material respect.

3.2 I/We hereby undertake that at any time after the happening of an Action of default hereunder and upon notice to me/us of such default by __________ Modaraba I/we shall purchase the Asset(s) from __________ Modaraba at the purchase price which shall be the facility amount together with all other costs, charges, expenses and damages etc. incurred / sustained by ___________ Modaraba in respect of the acquisition, registration and Takaful / insurance of the Asset(s) ("Purchase Price").

3.3 In the event of default by me/us you are authorized and entitled to exercise all rights and remedies to sell the Assets (s) in the market to recover the Purchase Price and other actual cost incurred. 1/we shall pay to you the difference (if any) between the price at which the Asset(s) was sold by you and the Purchase Price along with any cost incurred in acquiring the said Asset (s) the by __________ Modaraba.

4. Indemnities

4.1 I/We shall indemnify _________ Modaraba against any loss or expense which __________ Modaraba shall claim as having been incurred by it as a consequence of (i) any default in payment by me/us of any amount due hereunder (ii) the occurrence of an Action of Default (iii) my/our failure to take on Ijarah Assets pursuant to clause 1 herein above.

4.2 I/we hereby authorized the Lessor to cancel/revoke the Ijarah facility before the execution of Ijarah Agreement at any time, if the Lessor found;

a) Financial position of Lessee is not sound

b) Negative CWR from SBP - Overdue reporting

c) Charged in by the Financial Institution

d) Defaulted in any other executed financial facility

f) Substantial Change in Ijarah value as agreed at the time of execution of this agreement.

5. Government Levies:

If any law or regulation or any order of any court, tribunal or authority has the effect of subjecting ___________ Modaraba to any stamp duty, fees, charges, penalties, or other government levies and other charges relating to the use of the assets or relating to Ijarah facility either on the date of execution of this Letter of Agreement to Ijarah or in future (hereinafter collectively referred to as "Duties") I/we shall be liable to pay such Duties/levies to ____________ Modaraba in addition to any amounts payable hereunder.

6. Representations and Warranties

6.1 I/We hereby represent and warrant to __________ Modaraba as under:

6.1.1	That I/we have full legal right, power and authority to enter into, execute and deliver this Letter of Agreement to Ijarah and to perform my/our obligations hereunder:
6.1.2	That this Letter of Agreement to Ijarah has been duly and validly authorized and executed and constitutes our valid and binding obligation, enforceable against us in accordance with its terms:

7. Duration

This Agreement to Ijarah shall come into effect on the date of its execution by me/us and shall expire on the date I/we Ijarah the assets from ___________ Modaraba in accordance with clause 1 herein above.

8. Assignment

This Letter of Agreement to Ijarah is personal to me/us and I/we shall not subcontract or otherwise delegate or assign any of my/our obligations hereunder without the prior written consent of ___________ Modaraba.

____

A/c Name

Witness-1 Witness-2

Signature ______________________ Signature __________________________

Name__________________________ Name______________________________

CNIC __________________________ CNIC______________________________

No. SCD/PR&DD/AMCW/168/2012 Islamabad, the 5th June, 2012

SECP CIRCULAR NO. 17/2012

Subject: **Additional Disclosures for Workers' Welfare Fund Liability by Collective Investment Schemes.**

1. Pursuant to an amendment to the Workers' Welfare Fund Ordinance, 1971 (WWI' Ordinance) in year 2008, Collective Investment Schemes (CIS) were brought within the scope of the WWF Ordinance, thus rendering them liable to pay contribution to WWF. However, CIS through their trustees have challenged the said applicability of WWF to CIS before the Honorable High Court, which is pending adjudication.

2. It has been observed that owing to the pending litigation regarding applicability of WWF to CIS, different practices are being followed by Asset Management Companies (AMCs) with regard to WWF liability. Certain AMCs are maintaining the requisite provision against WWF liability of CIS whereas others have not made any provision to this effect. Irrespective of the practice adopted by an AMC, in case the decision of the Honorable Court is against the current approach being followed by an AMC, it may adversely impact the existing or redeeming and potential unit holders of the CIS. Therefore, maximum possible disclosure of this fact is imperative in the larger interest of the stakeholders of CIS.

3. Although, AMCs are already making sufficient disclosure in the financial statements of CIS, additional disclosures regarding contingent WWF liability and its impact on the NAV and return of the CIS should also be provided in the monthly fund manager's reports, advertisements and offering documents of the CIS. Therefore, the Commission, in exercise of its powers under section 282D of the Companies Ordinance 1984 hereby directs all the AMCs to immediately make the following disclosures in the Fund Manager Report of CIS and in the advertisement containing NAV/return of the CIS being managed by them:

a) Where requisite provision is being maintained against the WWF liability–

> ***"The Scheme has maintained provisions against Workers' Welfare Fund's liability to the tune of Rs .... if the same were not made the NAV per unit/return of the Scheme would be higher by Rs ..../...........%age. For details investors are advised to read the Note .... of the latest Financial Statements of the Scheme."***

b) Where requisite provision is not being maintained or partially maintained against the WWF liability –

> ***"The Fund/Scheme has not made provisions amounting to Rs. .... against Workers' Welfare Fund liability, if the same were***

made the NAV per unit/return of the Scheme would be lower by Rs………/……… %age. For details investors are advised to read the Note………of the latest Financial Statements of the Scheme."

The CIS shall also give additional risk disclosure with regard to WWF liability in its Offering document under the heading "Risks".

4. This direction shall come into force with immediate effect and all the AMCs are required to ensure meticulous compliance in letter and

spirit. Any violation/circumvention of this direction shall be dealt with in accordance with the relevant provisions of the Companies Ordinance, 1984.

2012 PTR 1206 (H.C. Del.)

HIGH COURT OF NEW DELHI

Sanjiv Khanna and R.V. Easwar, Jj.

Commissioner of Income Tax
v.
Havells India Ltd.

FACTS/HELD

1. **Section 9(1)(vii)(b): Export sales is not a "source of income outside India". Expenditure on fully convertible debentures is deductible**

2. The assessee, an Indian company, paid Rs. 14.71 lakhs to a US company for 'KEMA' certification which was necessary to enable it to sell its products in the European markets. The assessee claimed that though the said amount was 'fees for technical services' u/s 9(1)(vii), it was paid "for the purpose of earning income from a source outside India" (i.e. the exports) and so it was not taxable in India u/s 9(1)(vii)(b). The AO & CIT (A) rejected the claim though the Tribunal upheld it. On appeal by the department, HELD reversing the Tribunal:

   (i) S. 9(1)(vii)(b) provides that fees for technical services payable by a resident in respect of services utilised in a business or profession carried on by such person outside India or for the purposes of making or earning any income from any **source outside India** shall not be taxable in India. The term "**source**" means not a legal concept but one which a **practical man** would regard as a **real source of income**. It is a spring or fount from which a clearly defined channel of income flows. The assessee manufactured goods in India and concluded the export contracts in India. The source of income is created the moment the export contracts are concluded in India. **The customer located outside India is not the source of the income though he is the source of the monies received**. There is a distinction between the source of income and the source of receipt of monies. In order to fall u/s 9(1)(vii)(b), the source of the income, and not the receipt, should be situated outside India. Further, though the profits arise both from the manufacturing activity and from the sale, **bifurcation of the fees** is not permissible (Aktiengesellschaft 262 ITR 513 (Mad) not followed);

(ii) Also held that expenditure on fully convertible debentures could not be treated as expenditure on equity and was deductible even though the time and conversion price was fixed (Secure Meters Ltd 321 ITR 611 (Raj) (SLP dismissed) followed)

Appeals disposed of.

ITA Nos.55 & 57 of 2012.
Heard on: 7th May, 2012.
Decided on: 21st May, 2012.
Present at hearing: Sanjeev Sabharwal, Sr. Standing Counsel, for Appellant. Ajay Vohra, Kavita Jha & Somnath Shukla, Advocates, for Respondent.

JUDGMENT

R.V. Easwar, J.–

These are two appeals filed by the Revenue under Section 260A of the Income Tax Act, 1961 ('Act', for short). They relate to the assessment year 2005-06. Both the appeals arise out of the common order passed by the Income Tax Appellate Tribunal on 27.05.2011 in cross appeals filed by the assessee and the Revenue in ITA No.1300/Del/2010 and ITA No.2093/Del/2010 respectively.

2. The following substantial questions of law were framed by us:–

1. Whether the Income Tax Appellate Tribunal is right in holding that Section 40(a)(ia) of the Income Tax Act, 1961 is not applicable to testing fee of Rs. 14,71,095/- paid to M/s. CSA International, Chicago as there was no failure on the part of the respondent-assessee to deduct tax at source?
2. Whether the Income Tax Appellate Tribunal was right in holding that the pre operative expenses of Rs. 2,31,253/- can be allowed as a revenue expenditure?
3. Whether expenditure of Rs. 92,67,841/- incurred by the Assessee on fully convertible debenture issue is revenue expenditure or capital expenditure?

3. We are concerned with the assessment year 2005-06. The assessee is a company engaged in the manufacture of switch gears, energy meters,

cables and wires, electrical fans, compact florescent lamp and related components. It also trades in luminaires, lighting fixtures and exhaust fans.

4. As regards first substantial question of law, the brief facts are as follows. The assessee paid a sum of Rs. 14,71,095/- to M/s. CSA International, Chicago, Illinois, USA for the purpose of obtaining witness testing of AC contractor as part of CB report and KEMA certification. The US Company had specialised knowledge and facilities for carrying out the type of testing and the necessary certification, which was required by the assessee. In the course of the assessment proceedings, the Assessing Officer noticed that the assessee had not deducted tax at source under Section 195 of the Act from the amount paid to the US Company. He accordingly proposed to disallow the payment by invoking Section 40(a)(ia) of the Act. The assessee by letter dated 04.10.2007 stated that the amount was paid as testing charges to the US Company, that the testing was carried out by the US Company outside India, that no income arose or accrued to the US Company in India and, therefore, the assessee did not deduct any tax from the amount paid. The assessee, therefore, claimed that the provisions of Section 40(a)(ia) cannot be invoked to disallow the payment on the ground of non-deduction of tax at source.

5. The Assessing Officer did not agree with the assessee's contentions. According to him the assessee was not right in saying that no income had accrued or arisen to the US Company in India. According to him the deeming provisions of Section 9(1)(vii) of the Act was applicable and that the amount paid represented fees for technical services rendered by the US Company to the assessee within the meaning of Explanation 2 below Section 9(1)(vii)(b) of the Act. According to the Assessing Officer the testing of the equipment was a highly specialised job of technical nature and, therefore, the amount paid by the assessee to the US Company represented consideration for the rendering of technical services to the assessee. He, therefore, held that the amount was assessable in the hands of the US Company as income deemed to have accrued or arisen in India and since no tax was deducted by the assessee from the remittance of the amount, Section 40(a)(ia) came into operation and thus the amount of Rs. 14,71,095/- fell to be disallowed. The Assessing Officer also referred to Article 12(4)(b) of the agreement for the avoidance of double taxation entered into between India and USA and observed that the payment was also covered under the said article as "fees for included services" as defined therein. According to the Assessing Officer, the testing report and certification represented technical services which made available technical knowledge, experience and skill to the assessee because they were utilized in the manufacture and sale of the products in the business of the assessee. In this view of the matter the Assessing Officer disallowed the amount of Rs. 14,71,095/- under Section 40(a)(ia) of the Act.

6. The assessee appealed to the CIT (Appeals) against the disallowance. The CIT (Appeals) referred to the judgment of the *Kerala High Court in Cochin Refineries Ltd. vs. CIT*, (1996) 222 ITR 354 and held that the payment made by the assessee to the US Company was for obtaining technical services for the purpose of its business and such services were utilised in the manufacture and sale of the assessee's products. He accordingly agreed with the Assessing Officer that Section 195 of the Act was applicable. He, therefore, held that the amount was rightly disallowed under Section 40(a)(ia) for not being subjected to deduction of tax.

7. The assessee carried the matter in further appeal to the Tribunal in ITA No.1300/Del/2010. Several contentions were raised before the Tribunal on behalf of the assessee. The principal contentions were:–

(a) That Section 9(1)(vii)(b) of the Act exempted from tax the fees for technical services if they were paid for services which were utilised by the assessee in a business or profession carried on outside India or for the purpose of making or earning any income from any source outside India. Since the assessee was making exports to other countries, the fees for technical services were paid for the purpose of making or earning income from a source outside India and hence the payment was not chargeable to tax in India. There was thus no liability to deduct tax.

(b) The departmental authorities erred in concluding that the technical report and certification were utilised in the manufacture and sale of the assessee's products in the assessee's business in India.

(c) The KEMA certification enables the assessee to sell its products freely in the European Union. The assessee exports the products which bear the KEMA certification and that such certification is not required in India or by the Indian buyers and the taxing authorities were wrong in saying that the technical services were utilised by the assessee for its business in India.

(d) In any case under Article 12(4)(b) of the double tax avoidance agreement between India and USA makes it a condition that the mere rendering of technical services is not sufficient and that it is also necessary, in order that the fees for included services are taxable in India, that such services should have resulted in "making available" to the assessee technical knowledge, experience and skill.

8. The Tribunal, on the basis of arguments and the materials placed before them and after referring to Section 9(1)(vii)(b) of the Act recorded the following findings:–

(a) The certification obtained by the assessee from the US Company was for enabling the export of its products.

(b) The income tax authorities have not been able to bring anything on record to support their stand that the service of testing and certification has been applied by the assessee for its manufacturing activity within India.

(c) The CIT (Appeals) has not specifically met the contention of the assessee, raised before him, that the technical services were rendered by the US Company outside India and the assessee has also utilised them outside India and the payment was also received by the US Company outside India. The assessee's contention was that the technical services were utilised for the purpose of making or earning any income from any source outside India and was therefore covered by the second exception made in Section 9(1)(vii)(b) of the Act.

(d) The assessee has been able to show that the testing and certification were necessary for the export of its products and that these were actually utilised for such export and were not utilised for the business activities of production in India. The assessee has thus discharged its burden, whereas the Revenue has not been able to show to the contrary and they have not denied that the utilisation of the testing and certification was in respect of the exports.

In view of the above findings, the Tribunal deleted the disallowance made under Section 40(a)(ia) of the Act.

9. It is against the aforesaid decision of the Tribunal that the Revenue has come in appeal before this Court. It appears to us on a reading of the orders of the departmental authorities and the order of the Tribunal that there is no dispute that the amount paid by the assessee to the US Company represented "fees for technical services" within the meaning of Section 9(1)(vii)(b) of the Act. In fact, to the specific query put by us in the course of the hearing to the learned counsel for the assessee, he frankly stated that he could not dispute this position, having regard to the wide definition of "fees for technical services" in the aforesaid provision. If that is so, the only question which we are required to examine is (a) whether the fees were payable in respect of services utilised in a business or profession carried on by the assessee outside India or (b) they were paid for the purposes of making or earning any income from any source outside India. In either of these two cases, the amount paid will not be taxable in the hands of the non-resident company and correspondingly there will be no liability upon the assessee to deduct tax under Section 195 of the Act. It was stated before us by the learned counsel for the assessee that exception (b) will be applicable in the assessee's case and not (a). In other words his contention was that the fees were payable for the purposes of making or earning income from a source outside India. He elaborated this by submitting that the certification by the US Company that the products turned out by the

assessee were KEMA certified and were fit for being used in European countries and in countries where such certification is accepted, was indispensable for the export of such products to those countries and accordingly the fees for such certification and testing were for the purposes of making or earning income from a source outside India. It was accordingly contended that the conditions of the second exception in Section 9(1)(vii)(b) of the Act were satisfied.

10. In support his contention, the learned counsel for the assessee drew our attention to a judgment of the Madras High Court in *CIT vs. Aktiengesellschaft Kuhnle Kopp & Kausch W. Germany By BHEL*, (2003) 262 ITR 513. In this case it was held that the exports of goods represented a source outside India. The High Court was concerned with Section 9(1)(vi) which was concerned with payment of royalty by a person resident in India to a non-resident. Though that provision was concerned with royalty, the exceptions provided from taxability of the royalty income in the hands of the non-resident are the same as in the case of fees for technical services dealt with in Section 9(1)(vii)(b) of the Act. In that case the resident company paid royalty to a West German company. The royalty was payable on export sales effected by the resident-assessee. The question before the High Court was whether the Tribunal was right in law in holding that the royalty on export sales was not taxable within the meaning of Section 9(1)(vi) of the Act. The High Court held as under:–

> *"As far as royalty on export sales is concerned, that amount is also exempt under section 9(1)(vi) of the Income-tax Act. Though the royalty was paid by a resident in India, it cannot be said that it was deemed to have accrued or arisen in India as the royalty was paid out of the export sales and, hence, the source for royalty is the sales outside India. Since the source for royalty is from the source situate outside India, the royalty paid on export sales is not taxable. The Appellate Tribunal was therefore correct in holding that the royalty on export sales is not taxable within the meaning of section 9(1)(vi) of the Income-tax Act."*

11. The judgment of the Madras High Court certainly supports the contention of the learned counsel for the assessee. In an earlier judgment in *CIT vs. Anglo French Textiles Ltd.*, (1993) 199 ITR 785, a Division Bench of the Madras High Court had occasion to consider a somewhat similar question arising under Section 9 of the Act. In that case the assessee was a company incorporated under the French laws which were applicable to possessions in Pondicherry in India. It had a textile mill in Pondicherry and its activity consisted in the manufacture of yarn and textiles as well as export of textiles from Pondicherry. The entire business operations were confined to the territory of Pondicherry. After the merger of Pondicherry with India in August, 1962, the Income Tax Act was extended to Pondicherry w. e. f. 1.4.1963. Till then, the French law relating to income tax was in force in Pondicherry. During the period

when the French tax law was in force, the assessee surrendered certain raw cotton import and machinery import entitlement and received payments from the Textile Commissioner (Bombay). The question arose as to the taxability of the income referable to the import entitlements. While the income tax department took the stand that the income accrued to the assessee outside Pondicherry and was therefore texalite under the Act, the assessee maintained that the receipts were only in Pondicherry and since the exports were made from Pondicherry, the income accrued or arose to the assessee in the territory of Pondicherry which was outside the purview of the Act. The Madras High Court observed that the import entitlements arose out of the export activity which was carried on by the assessee only in Pondicherry, that no part of the manufacturing or selling activity of the assessee was carried on outside Pondicherry, that the import entitlements were relatable only to the export performance which took place in Pondicherry and that on the fulfillment of the export activity, a right to receive the export incentive accrued in favour of the assessee in the territory of the Pondicherry. The argument of the department was that the incentive was quantified and sent from Bombay from the office of the Textile Commissioner and, therefore, the income arose within the taxalite territories. This argument was rejected by the Madras High Court by holding that "*the right to receive the import entitlements arose when the export commitment was fulfilled by the assessee in Pondicherry, though such amount was subsequently ascertained or quantified*". It was also argued on behalf of the Revenue before the High Court that the import entitlement should be regarded as a source of income in the taxable territories and under Section 9(1) of the Act, the income arising out of the encashment of the import entitlements should be deemed to accrue or arise in the taxable territories. This argument was also rejected by the Madras High Court which held:–

> *"Equally, it is difficult to regard the import entitlements as a source of income which should be looked at from a practical view-point and not merely as an abstract legal concept. We are, therefore, unable to agree with the contention of the learned counsel for the Revenue that the import entitlements constituted a source of income within the meaning of Section 9 of the Act as to deem the import entitlements as having accrued or arising in India."*

This earlier judgment of the Madras High Court does not appear to have been brought to the notice of the Division Bench which decided the later case. The observations of the Madras High Court in the earlier case, which we have quoted above, clearly suggest that the export activity or export sales were the source of the import entitlements and the export activity took place in Pondicherry and it was only on fulfillment of the export activity that a right to receive the import entitlement/ incentive accrued in favour of the assessee. Since the export activity was fulfilled in

Pondicherry, the source of income was located in Pondicherry. Applying this judgment to the facts before us in the present case, we have to conclude that the export activity having taken place or having been fulfilled in India, the source of income was located in India and not outside. Moreover, just as in the Madras case it was held that the mere fact that the import entitlements which had their source in Bombay, did not constitute a source of income within the meaning of Section 9 of the Act, we have also to hold in the present case that the mere fact that the export proceeds emanated from persons situated outside India did not constitute them as the source of income.

12. The question as to what is a source of income has been dealt with in some authoritative pronouncements. The Judicial Committee in *Rhodesia Metals Ltd. vs. Commissioner of Income Tax*, (1941) 9 ITR (Suppl.) 45 observed that a "source" means not a legal concept but one which a practical man would regard as a real source of income. This observation was adopted by Malik, J. in his separate but concurring judgment in the case of *Rani Amrit Kaur vs. CIT*, (1946) 14 ITR 561, a decision of the Full Bench of the Allahabad High Court. A source of income was described by R. S. Pathak, J. (as he then was) in the following words in *Seth Shiv Prasad vs. CIT*, (1972) 84 ITR 15 (All.) at page 18:–

> *"A source of income, therefore, may be described as the spring or fount from which a clearly defined channel of income flows. It is that which by its nature and incidents constitutes a distinct and separate origin of income, capable of consideration as such in isolation from other sources of income, and which by the manner of dealing adopted by the assessee can be treated so."*

The observations of the Judicial Committee (supra) as to what is a source of income have been approved by the Supreme Court in *CIT vs. Lady Kanchanbai*, (1970) 77 ITR 123. The location or situs of a source of income is another aspect. The third aspect is the accrual of the income. Though it is true, as held by Kania, C.J., speaking for a Constitution Bench of the Supreme Court in *CIT vs. Ahmedbhai Umarbhai*, (1950) 18 ITR 472 (SC) at page 479, that the place where the source of income is located may not necessarily be the place where the income also accrues, that question is not material in the present case because herein we are concerned only with the question as to the location of the source. The real question is whether the export sales proceeds received from goods manufactured and exported from India constitute a source inside or outside India. To decide the same we have to take a pragmatic and a practical view and not approach the question from a theoretical perspective.

13. Section 9(i)(vii)(b) contemplates a source located outside India. It is difficult to conceptualise the place/ situs of the person who make payment for the export sales as the source located outside India from which assessee earned profits. The export contracts obviously are

concluded in India and the assessee's products are sent outside India under such contracts. The manufacturing activity is located in India. The source of income is created at the moment when the export contracts are concluded in India. Thereafter the goods are exported in pursuance of the contract and the export proceeds are sent by the importer and are received in India. The importer of the assessee's products is no doubt situated outside India, but he cannot be regarded as a source of income. The receipt of the sale proceeds emanate from him from outside India. He is, therefore, only the source of the monies received. The income component of the monies or the export receipts is located or situated only in India. We are making a distinction between the source of the income and the source of the receipt of the monies. In order to fall within the second exception provided in Section 9(1)(vii)(b) of the Act, the source of the income, and not the receipt, should be situated outside India. That condition is not satisfied in the present case. The Tribunal, with respect, does not appear to have examined the case from this aspect. Its conclusion that the technical services were not utilised for the assessee's business activity of production in India does not bring the assessee's case within the second exception in Section 9(1)(vii)(b) of the Act. It does not bring the case under the first exception either, because in order to get the benefit of the first exception it is not sufficient for the assessee to prove that the technical services were not utilised for its business activities of production in India, but it is further necessary for the assessee to show that the technical services were utilised in a business carried on outside India. Therefore, we cannot also approve of the Tribunal's conclusion in para 29 of its order to the extent it seems to suggest that the assessee satisfies the condition necessary for bringing its case under the first exception. Be that as it may, as we have already pointed out, since the source of income from the export sales cannot be said to be located or situated outside India, the case of the assessee cannot be brought under the second exception provided in the Section.

14. Mr. Vohra, learned counsel for the assessee, however, contended that income arose not only from the manufacturing activity but also arose because of the sales of the products and if necessary a bifurcation of the income should be made on this basis and that portion of the income which is attributable to the export sales should qualify for the second exception. This argument is only a limb of the main contention that the income arises from the export sales and the source of the income is located outside India. We have already expressed our difficulty in accepting that argument. It is true that the profits arise both from the manufacturing activity and from the sale. There are several authorities dealing with this question in the context of cases where an assessee had its manufacturing facility in British India but sold the goods outside British India. In such cases, it has been held that the profits arose both from manufacture and the sales and that part of the profit which arises from sales outside British India would be exempt from tax: See *Anglo French Textiles Co.*

Ltd. vs. CIT, (1953) 23 ITR 101 (SC); CIT v. Ahmedbhai Umarbhai & Co. (supra).

But these cases are not of any assistance to the assessee in the present case since the contention here is that the source of income is the export sales and the export sales are located outside India.

15. For these reasons we are unable to hold that the assessee's case falls under the second exception provided in Section 9(1)(vii)(b) of the Act. In other words, we are unable to accept that the fees for technical services were paid by the assessee to the US Company for the purpose of making or earning any income from any source outside India.

16. The result of our discussion is that the fees for technical services are taxable in the hands of the US Company under the provisions of the Act. The question to be considered then would be whether there is anything in the agreement for avoidance of double taxation between India and USA which would exempt or reduce the burden of taxation in respect of the fees for technical services received by the US Company. This aspect of the matter has not been examined by the Tribunal, though raised before it by the assessee, since there was no occasion for the Tribunal to do so on account of the view it took regarding the taxability of the fees for technical services under the Act. It is axiomatic that if the receipt is not taxable under the Act, then there is no need to examine whether it would fall under any of the provisions of the agreement for avoidance of double taxation. We cannot therefore find fault with the Tribunal for not having discussed the applicability of Article 12 of the Indo-US Treaty, which defines "fees for included services" in a manner which is different from the definition of "fees for technical services" in Explanation 2 below Section 9(1)(vii) of the Act. It would therefore not be proper or necessary for us to examine the applicability of the treaty which should be left to the Tribunal. While therefore answering the first substantial question of law in the negative, in favour of the Revenue and against the assessee, we restore the issue relating to the applicability of the Indo-US treaty to the receipt in question and consequently the applicability of Section 40(a)(ia) of the Act to the Tribunal.

17. As regards the second substantial question of law, the brief facts are as follows. In the course of the assessment proceedings it was noticed by the Assessing Officer that the assessee had undertaken a project at Haridwar for installing a unit engaged in the manufacture of fans, etc. and that in the books of accounts it has been capitalising the expenses incurred towards the project as capital works in the progress. The total of such expenses incurred up to the end of the accounting year relevant to the assessment year 2005-06 was Rs. 2,31,253/-. In the computation of income the assessee had claimed the expenses as a deduction on the ground that these were expenses incurred in the course of its regular business and were related to the expansion of the existing business. The Assessing Officer, relying on the accounts of the assessee, held that the

expenses should be treated as capital in nature since the Haridwar Unit was not dependent on the existing business of the assessee and vice-versa. Applying the test of the closure of one business not affecting the continuance of the other and relying on some authorities, the Assessing Officer disallowed the expenditure as capital in nature.

18. On appeal, the CIT (Appeals) examined the details of the expenses and found that they represented salaries, travelling expenses and other commercial expenses in connection with the expansion of the existing business. According to the CIT (Appeals), there was no provision in the Act permitting the allowance of the expenses mentioned above during the construction period or during the period before the assets were first put to use. He noted that the assessee was not able to substantiate the contention that it was only a case of expansion of the existing business and was not able to lead evidence regarding interlacing and interdependence between the existing and new units. He further noted that in the accounts the assessee had capitalised the expenses. In this view of the matter he upheld the disallowance.

19. The assessee carried the matter in further appeal before the Tribunal. The Tribunal examined the director's report, the financial statements and the notes appended thereto etc. and found that there was complete interlacing and intermingling of the funds of the assessee in all its units besides there being a common management. The Tribunal also referred to the judgment of this Court in *CIT vs. Monnet Industries Ltd.*, (2009) 221 CTR 266 and applying this decision to the facts found, it held that the expenditure was revenue in nature having been incurred for the expansion of the existing business and accordingly directed the Assessing Officer to allow the same as deduction.

20. Having heard both the sides on this question, we are satisfied that the Tribunal has taken the right view of the matter. There is no challenge to the factual findings recorded by the Tribunal on the basis of the financial statements and the director's report before them, to the effect that (a) that the Haridwar Unit was only a expansion of an existing business of the assessee and (b) that there was intermingling and interlacing of the funds of the Units and (c) there was a common management. This is the usual test which has been deduced by the Courts in India, following the locus classicus on the subject, which is that of the House of Lords in the case of *Scales vs. George Thompson & Co. Ltd.*, 13 TC 83 where the test laid down by Rowlatt, J. was whether there was interconnection, interlacing, interdependence and a unity embracing the different businesses. If this test is answered in the affirmative, all the businesses constituted the same or single business with the result that expenditure incurred by the assessee in respect of the expansion of an existing business would fall to be considered as revenue expenditure. The fact that in the books of account the assessee had capitalised the expenses does not prevent the assessee from claiming them as revenue

expenses since the question of allowance of expenses has to be considered in the light of the legal position and the accounting treatment cannot be conclusive. In the present case considering the undisputed factual findings of the Tribunal, the substantial question of law is answered in the affirmative, in favour of the assessee and against the Revenue.

21. We may now turn to the third question. The brief facts in this connection are as follows. During the relevant previous year, the assessee issued 4% fully convertible debentures amounting to Rs. 2350 lakhs comprising of 235 debentures of the face value of Rs. 10 lakhs each to another company by name M/s. Shine Ltd. which was incorporated under the laws of Mauritius. The issue of debentures was to give effect to the investor agreement entered into with the Mauritius Company. Necessary amendments were made to the Articles of Association of the assessee-company. In connection with the debentures issued the assessee had incurred the following expenditure:–

(i)	Paid to M/s. Price Water House Coopers (P) Ltd.	5332500/-
(ii)	Paid to M/s. Wadia Chandy & Co.	639450/-
(iii)	Payment M/s. KPMG India Pvt. Ltd.	4,88,768/-
	Total	64,60,718/-

22. In addition to the aforesaid expenditure, the assessee also paid interest of Rs. 28,07,123/- on the debentures in the relevant previous years. The aggregate of all the four items of expenditure came to Rs. 92,67,841/-.

23. The above expenditure was claimed as revenue expenditure in the return of income. The Assessing Officer was of the view that the debenture issue was in fact an issue of equity share capital to the Mauritius Company and accordingly the entire expenditure should be disallowed as capital expenditure. In support of this conclusion he referred to the board resolution in which it was stated that the FCDs would be converted into equity shares on or before 12.06.2006 and these shares would be issued to the Mauritius Company. It was also mentioned in the resolution that the Mauritius Company would be entitled to bonus shares in the ratio of 1:1and they will be allotted at the time of conversion of the debentures. According to the Assessing Officer, this actually meant that the assessee was in fact making an issue of share capital and according to the judgments of the Supreme Court in *Brooke Bond India Ltd. vs. CIT*, (1997) 225 ITR 798 and *Punjab State Industrial Development Corporation vs. CIT*, (1997) 225 ITR 792, any expenditure incurred in relation to the expansion of the capital base of a company should be treated as capital expenditure. He accordingly disallowed the expenditure of Rs. 92,67,841/-.

24. On appeal the CIT (Appeals) referred to the judgment of the Rajasthan High Court in *CIT vs. Secure Meters Ltd.*, (2010) 321 ITR 611

(Raj.) in which it was held that the position has to be examined only with reference to the time when the debentures were issued and that the fact that at a future point of time they were to be converted into shares was irrelevant in order to decide the allowability of the expenditure incurred in connection with the debenture issue, and allowed the expenditure as revenue expenditure. He also noted that the SLP filed by the revenue against the judgment of the Rajasthan High Court (supra), was dismissed on 11.08.2009. He accordingly directed the Assessing Officer to allow the expenditure as revenue expenditure. His decision was affirmed by the Tribunal in the appeal by the revenue in ITA No.2093/Del/2010.

25. The Revenue is in appeal. The main contention on its behalf is that the position should be seen not only with reference to time at which the debentures are issued but the fact that at a future point of time they were to be converted in shares should also be taken note of in order to judge the allowability of the expenditure incurred in connection with the debenture issue. It was submitted that on the facts of the present case, the debentures were to be converted within a period of 15 months, that is on or before 12.06.2006, and that the assessee company had even fixed the price at which the shares would be issued upon conversion of the debentures, and that even the issue of bonus shares had been finalised at the time of the debenture issue and all these facts clearly showed that the issue was in truth and effect only an issue of share capital. It was accordingly contended that the judgments of the Supreme Court cited supra were squarely applicable.

26. It is well settled that expenditure incurred in connection with the issue of debentures or obtaining loan is revenue expenditure. Reference in this connection may be made to the leading judgment of the Supreme court in *India Cements Ltd. vs. CIT*, (1966) 60 ITR 52. The question before us however, is whether it is a debenture issue or an issue of share capital involving the strengthening of the capital base of the company. Though it prima facie appears that there are sufficient facts to indicate that what was contemplated was an issue of shares to the Mauritius Company under the Investor Agreement which would result in strengthening of the assessee's capital base, having regard to the judgments cited on behalf of the assessee, in which it has been held that despite indications to the effect that the debentures are to be converted in the near future into equity shares, the expenditure incurred should be allowed as revenue expenditure on the basis of the factual position obtaining at the time of the debenture issue, we are not inclined to take a different view. The following cases have been cited on behalf of the assessee in support of the view that even in such a situation the expenditure is allowable as revenue expenditure:–

(i) *CIT vs. East India Hotels Ltd.*, (2001) 252 ITR 860 (Cal.)

(ii) *CIT vs. ITC Hotels Ltd.*, (2011) 334 ITR 109 (Kar.)

(iii) *CIT vs. South India Corporation (Agencies) Ltd.*, (2007) 290 ITR 217 (Mad.)

(iv) *CIT vs. First Leasing Co. of India Ltd.*, (2008) 304 ITR 67 (Mad.)

27. In addition to the above judgments, we also have the judgment of the Rajasthan High Court (supra) against which the Special Leave Petition filed by the Revenue was dismissed. Having regard to the predominant view taken in the above judgments, in which the judgment of the Supreme Court in India Cement (supra) has been noticed, we are inclined to uphold the view taken by the Tribunal that the expenditure is revenue in nature. Accordingly, we answer the substantial question of law in favour of the assessee and against the revenue.

28. In the result the appeals filed by the revenue are disposed of with no order as to costs.