

**09th OF 2024 KTBA ONE PAGER
CASE LAW UPDATE
(AUGUST 25, 2024)**

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Dear Members,

A brief update on a judgment by the Appellate Tribunal Inland Revenue on **“Sales Tax payment borne by business and not transferred to consumers, is a deductible expense”** is being shared with you for your knowledge. The order has been attached herewith the update.

This update is in line with the efforts undertaken by our **“CASE LAW UPDATE COMMITTEE”** to apprise our Bar members with important court decisions.

You are equally encouraged to share any important case law, which you feel that should be disseminated for the good of all members.

You may contact the Committee Convener Mr. Shams M. Ansari or at the Bar’s numbers 021-99212222, 99211792 or email at info@karachitaxbar.com & ktba01@gmail.com

(Syed Zafar Ahmed)
President

(Asim Rizwani Sheikh)
Hon. General Secretary

**09th OF 2024 KTBA ONE PAGER
CASE LAW UPDATE
(August 25, 2024)**

SALES TAX PAYMENT BORNE BY BUSINESS AND NOT TRANSFERRED TO CONSUMERS, IS A DEDUCTIBLE EXPENSE

Appellate Authority: Appellate Tribunal Inland Revenue
Appellant: Capital Foods (Private) Limited
Sections Involved: Section 21(a) of the Income Tax Ordinance, 2001 and Section 13 of the Sales Tax Act, 1990

Background:

The appellant company engaged in the manufacturing and sale of bakery products, which were partly taxable and partly exempt under section 13 of the Sales Tax Act, 1990 (the Act), was found to claim sales tax consumed against exempt supplies as part of the cost of sales while filing Return of Income for Tax Year 2018. Such claim was deemed as non-compliant with the provisions of section 21(a) of the Ordinance by the Additional Commissioner of Inland Revenue (ADCIR), who issued a notice under section 122(9) read with section 122(5A) of the Ordinance. The appellant's response to the notice was treated as inadequate; consequently, the appellant's income was reassessed after disallowance of the deductions claimed on account of sales tax payments pertaining to exempt supplies. The taxpayer sought further redressal before the Appellate Tribunal Inland Revenue, Islamabad (the ATIR).

First Ruling of the ATIR:

Sales tax payment falls outside the purview of section 21(a)

The ATIR ruled that the sales tax is imposed on the transaction of sales and purchases of goods, rather than on the profits or gains derived from business activities. Accordingly, sales tax does not fall within the purview of clause (a) of Section 21 of the Ordinance, which prohibits deductions on account of taxes paid on profits or gains. The ATIR held that the assessing officer wrongly treated a tax imposed on transaction of sales and purchases as tax imposed on income under the garb of clause of (a) of section 21 of the Ordinance as the former falls outside the purview of the said section. The ATIR cited the legal precedents to substantiate its interpretation consisting of **S.R.V. G. Press Co Vs Commissioner of Excess Profit Tax (CEPT), (1956) 30 ITR 583** and **A.V. Thomas & Co Ltd Vs CIT, (1986) 159 ITR 431**.

Second Ruling of the ATIR:

Sales tax borne by the business and not transferred to the customer is a deductible expense

The ATIR held that the sales tax in question pertained to the purchases made in respect of exempt supplies and thus, the sales tax paid by the Appellant could not be transferred to its customer. Resultantly, such tax payment was embedded in the cost incurred for the purpose of Appellant's business. Therefore, the said sales tax payment qualifies as a deductible business expense under section 20 of the Ordinance. The assessing officer was ought to consider such sales tax payment as an allowable expense instead of disallowing the same under Section 21(a) of the Ordinance on the basis of incorrect assumption that such tax constituted a levy on business profits or gains.

Conclusion:

The Appellate Tribunal Inland Revenue has concluded that the appellant's claim of sales tax paid on purchases as part of the cost of sales is lawful. It has been established that the sales tax in question is not levied on the profits or gains of the business but is a legitimate business expense incurred in the course of operations, irrespective of profitability. As such, the application of Section 21(a) by the assessing officer to disallow this expense was a misapplication of the said provision. Consequently, the orders of the lower authorities were set aside, and the appeal was decided in favor of the Appellant.

DISCLAIMER:

This update has been prepared for KTBA members and carries a brief narrative on a detailed Judgment and does not contain an opinion of the Bar, in any manner or sort. It is therefore, suggested that the judgment alone should be relied upon. Any reliance on the summary in any proceedings would not be binding on KTBA.

**APPELLATE TRIBUNAL INLAND REVENUE, DIVISION BENCH-I,
ISLAMABAD**

ITA No.2582/IB/2022
(Tax Year 2018)

Capital Foods (Private) Limited, 15-E,
Naseerabad, Peshawar Road, Appellant
Rawalpindi.

Vs

Commissioner Inland Revenue,
Zone-I, CTO, Islamabad. Respondent

Appellant By: Mr. Anwar-ul-Haq, ACA
Respondent By: Ms. Sobia Mazhar, DR

Date of Hearing: 11.01.2023
Date of Order: 11.01.2023

ORDER

M. M. AKRAM (Judicial Member): The titled appeal has been filed by the appellant taxpayer against the impugned Appeal Order No. 464/2022 dated 25.11.2022 passed by the learned Commissioner Inland Revenue (Appeals-IV), Islamabad for the tax year 2018 on the grounds as set forth in the memo of appeal.

2. Brief facts giving rise to the instant appeal are that the appellant is engaged in the business of manufacturing and sale of bakery items. During the scrutiny of the return of income and audited financial accounts for the tax year 2018 it transpired that the appellant has claimed "sales tax consumed" as part of the cost of sales which was not admissible under the law. Further, the taxpayer adjusted WWF against the refund for the tax year under consideration whereas the same cannot be adjusted from an income tax refund. On the aforesaid basis, the Additional Commissioner IR (Add CIR) observed that the assessment deemed to be finalized under section 120(1)(b) of the Income Tax Ordinance, 2001 (**the Ordinance**) was erroneous in so far as prejudicial to the interests of revenue.

Notice under section 122(9) read with section 122(5A) of the Ordinance was issued on 02.04.2021 for compliance by 12.04.2021. In response to the notice, the taxpayer applied for adjournment which was allowed till 28.04.2021. A reminder was issued on 27.08.2021 for compliance by 01.09.2021. In response to the notice, the taxpayer submitted an online reply which was found unsatisfactory by the Add CIR. Proceedings were finalized whereby income was assessed at Rs.26,477,405/- against declared at Rs.13,090,581/-. A tax liability of Rs.1,032,395/- was created.

Being aggrieved, the appellant taxpayer filed an appeal before the learned Commissioner Inland Revenue (Appeals), Islamabad who vide appeal Order No. 464/2022 dated 25.11.2022 confirmed the order passed by the Additional Commissioner Inland Revenue. Aggrieved with this order, the taxpayer has preferred an appeal before this forum and assailed the impugned orders on a number of grounds.

3. This case came up for hearing on 11.01.2023. The learned AR for the appellant contended that the appellant is involved in the manufacturing and sales of food items and such items are partly taxable and partly exempt from sales tax under section 13 of the Sales Tax Act, 1990. The sales tax paid on purchases was partly adjusted against taxable goods and partly claimed input tax non-attributable to taxable supplies to the tune of Rs.13,601,488/- as cost of sales in the accounts to reach the realistic cost of sales and actual gross profit of the taxpayer. Thus, it is an allowable business expense under the law. He contended that the provision of section 21(a) of the Ordinance does not apply in the instant case. He explained that according to the said section, only the tax paid or payable on the profit or gain of the business is an inadmissible

deduction whereas the sales tax paid on purchases is not a tax on profit and gain of the business and as such does not come within the ambit of clause (a) of section 21 of the Ordinance. He, therefore, pleaded that the disallowance of sales tax paid on purchases is unsustainable in law. On the other hand, the learned DR appeared on the behalf of the Department opposed the submissions of the appellant and contended that the order passed by the learned CIR (A) is a speaking order and there is no infirmity in the impugned order.

4. We have heard and perused the relevant record as well keeping in view the facts of the case and the law relevant thereto. The submissions made on behalf of the appellant have substance. The only issue involved in the instant case is whether sales tax paid on purchases is a deductible business expense if it is not passed on to the end consumer. The assessing officer disallowed the expense under the garb of section 21(a) of the Ordinance. To resolve the controversy, it would be advantageous for better understanding to reproduce the relevant provision of section 21 of the Ordinance: -

“Section 21. Deduction not allowed. – Except as otherwise provided in this Ordinance, no deduction shall be allowed in computing the income of a person under the head “Income from business” for-

(a) any cess, rate or **tax paid or payable** by the person in Pakistan or a foreign country that is levied **on the profits or gains of the business** or assessed as a percentage or otherwise on the basis of such profits or gains;” (Emphasis supplied)

It can be seen from a bare reading of the above provision of law that only the tax paid or payable by a person that is levied on the profits or gains of the business is not allowed to be deducted as a business expense. The sales tax paid

on purchases is not a tax paid or payable on profits and gains rather it is a business expense before arriving at the taxable profit, therefore, it does not come within the ambit of clause (a) of section 21 reproduced above. Sales Tax and Excise Duty are deductible expenses where that are to be absorbed by the business; otherwise, these are passed on to the consumer. Now the sales tax is levied on sales or purchases of goods by traders and not upon the profits and gains made by them from the business. Sales tax is payable irrespective of any profit being earned and without such payment, the business of buying and selling cannot be carried on. Hence, it is exclusively for the purpose of business. It is, therefore, deductible as a business expense under section 20 of the Ordinance before arriving at the taxable profit. Reliance may be placed on **S.R.V. G. Press Co Vs Commissioner of Excess Profit Tax (CEPT)**, (1956) 30 ITR 583 and **A.V. Thomas & Co Ltd Vs CIT**, (1986) 159 ITR 431. Thus, the appellant had rightly claimed the sales tax as part of the cost of sales which was not passed on to the end consumer. Therefore, the addition made to this account is deleted and the orders passed by the lower authorities are annulled. As a result, the appeal of the appellant is accepted.

Sd/-
(M. M. AKRAM)
JUDICIAL MEMBER

Sd/-
(MUHAMMAD IMTIAZ)
ACCOUNTANT MEMBER

CERTIFICATE U/S 5 OF THE LAW REPORT ACT

This case is fit for reporting as it settles the principles highlighted above.

(M. M. AKRAM)
JUDICIAL MEMBER