

KTBA CASE LAW UPDATE

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Dear Members,

A brief update on a recent judgement on “Undeclared Sales under Section 111 cannot be taxed on gross amount but on the amount of Net Income earned from it.” by Lahore High Court is being shared with you for your knowledge.

This update is in line with the efforts undertaken by our “CASE LAW UPDATE COMMITTEE” with the larger goal to assist and 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.

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

(Zafar Ahmed)
President

(M. Mehmood Bikiya)
Hon. General Secretary

KTBA CASE LAW UPDATE (Update # 3 of 2023 dated April 20, 2023)

Undeclared Sales under Section 111 cannot be taxed on gross amount but on the amount of Net Income earned from it.

Appellate Authority: Supreme Court of Pakistan

Appellant: Commissioner Inland Revenue, Lahore

Section: 111(1)(d) of the Income Tax Ordinance, 2001
Detailed judgment was issued on May, 31 2022 reported as 2023 SCMC 523.

Background: Appeal filed by the Department against a judgment of Lahore High Court was dismissed by the Supreme Court and the addition of undeclared sales under section 111(1)(d) of the Income Tax Ordinance, 2001 [the Ordinance], which was taxed under Section 122(5) of the Ordinance at gross amount without deduction of cost, has been declared to be illegal.

Decision of the Court:

First Ruling of the Court: The Supreme Court rejected the argument of the department that amount of undeclared sales could be added to the income at gross amount without deduction of cost. It held that the true meaning of phrase 'chargeable to tax' refers to net income from sales as income from sale means net income from it, not the gross, unless the sales is subject to Final Taxation Regime.

Second Ruling of the Court: The Court further examined the issue of 'tax on net income' by referring to Section 122(5) where the Commissioner can tax any income, which has escaped taxation, based on "definite information" he is possessed with, in the case. The Court observed that a careful review of provisions of Section 122(5) patently reflects the intent of the legislature that it is the net income from sales or production, which is liable to tax, not its gross amount. It was held that if 'sales or production' are allowed to be taxed at gross then two different results would follow from the two Sections of 122(5) and 111(1)(d), which cannot be permitted under the law as otherwise it will gravitate misuse of discretion.

Third Ruling of the Court: The court deprecated the use of discretionary powers of the Tax Officer (TO) who may exercise powers under Section 111(1)(d) to impose higher tax on gross amount instead of lower tax under Section 122(5) on the net amount. Thus this situation would lead to unfettered discretion at the hands of the TO, which again cannot be permitted in the light of law as laid down in PLD 1958 SC 157. It has been held that where an unrestricted discretion is conferred on tax authorities, without any yardstick or measure for applying any one of the two provisions, it will end in different tax liabilities being inflicted upon the taxpayer.

Fourth Ruling of the Court: The court also considered the limitation viz. a viz. Section 122(5) or 111 for making addition, while dilating upon the use of discretionary powers that though there is a five (05) years' time limitation for action under Section 122 and none under Section 111, which again gives an option to the TO, ruled that it is the duty of FBR to check the misuse of discretion.

Conclusion:

The Court concluded that the actions of the TO shall be subject to judicial scrutiny and the FBR has been directed to consider the following steps:

(a) Action may only be taken under Section 122(5) instead of Section 111(1)(d) and in case Section 111(1)(d) is preferred, the reasons for the same must be given.

NOTE: Members are requested to read the complete order attached herewith.

(b) In case the Tax Officer initiates action under Section 111(1)(d) after expiry of five (05) years' limitation and taxpayer contests that the information was very much in the knowledge of the Tax Officer already then the TO will have to give reasons as to why action was not taken under Section 122.