

IN THE HIGH COURT OF SINDH AT KARACHI

ITR No. 178 of 1997

Before : **Mr. Justice Irfan Saadat Khan**
Mr. Justice Fahim Ahmed Siddiqui

M/s. Schlumberger Seaco Inc. Applicant.

Versus

The Deputy Commissioner of
Income Tax, Circle C-12,
Companies-I, Karachi. Respondents

Dates of hearing: **19.09.2019 & 24.10.2019**
 Date of judgment: _____

Applicant M/s. Schlumberger Seaco Inc. through Mr. Arshad Siraj, advocate.

Respondent The Deputy Commissioner of Income Tax through Mr. Muhammad Aqeel Qureshi, advocate.

J U D G E M N T

FAHIM AHMED SIDDIQUI, J:- This income tax reference was referred to this Court by the Income Tax Appellate Tribunal (Pakistan), Karachi for determination of the following question of law:

“Whether the income of the non-resident insurance companies was chargeable to tax in Pakistan under the provisions of the Income Tax Ordinance, 1979?”

2. After initial hearing of the parties and scrutinising the record, we are of the view that the referred question of law is more appropriately rephrased as under:

“Whether the premium paid by an assessee to a non-resident insurance company was chargeable to tax in Pakistan under the Income Tax Ordinance, 1979 (hereinafter referred as ‘the Ordinance’) if there is a tax avoidance treaty between Pakistan and the country of origin of the said company?”

3. The factual matrix of the case is that the applicant has paid a certain amount as premium to two different non-resident insurance companies having their permanent establishments within the territory of the United Kingdom and the United States of America respectively. Pakistan has already signed tax avoidance treaties for avoidance with both the countries. Since the demand for deduction of taxes on such premium was raised; therefore, the aforementioned question of law was formulated.

4. Mr. Arshad Siraj, the learned counsel for the appellant, opens his arguments by submitting that the international treaties should be respected and the same have an over-riding effect on the provisions of the Ordinance. After drawing our attention towards Section 9 of the Ordinance, he submits that the tax can only be charged subject to the provisions of the Ordinance. After referring Sections 11(b) and 12(3)(b) of the Ordinance, he defines the income of a non-resident, earned by him in Pakistan. He further crystallises his arguments by submitting that Pakistan has already entered into similar treaties for double tax avoidance; therefore, the said treaties should be given preference to any provisions of the Ordinance as per Section 163 of the Ordinance. In this respect, he also refers different articles of both the treaties. While capping his arguments, he submits that the applicant is not required under the law to deduct income tax from the insurance premium paid to a non-resident insurance company. In support of his submissions, he relied upon the

cases of **Messrs EFU General Insurance Ltd vs. Federation of Pakistan (2010 PTD 1159)**, **Commissioner of Income Tax, Karachi vs. Grindlays Bank PLC, Karachi (2010 PTD 2012)**, and **Commissioner Inland Revenue (Legal Division) vs. Messrs Geofizyka Krakow Pakistan Ltd (2017 SCMR 140)**.

5. Conversely, Mr. Aqeel Ahmed Qureshi, learned counsel representing the department, submits that every receipt is income and as per the provisions of Section 15 of the Ordinance and all incomes generated to a person should be taxed as per the provisions of the Ordinance. However, he conceded that if there is an unambiguous provision within the treaty regarding avoidance of tax then the same ought to be respected.

6. We have heard the arguments and have scanned the available record, cited case laws, and referred treaties.

7. Every country seeks to tax the income generated within its boundaries on the basis of one or more connecting factors e.g. location, source, the residence of the taxable entity, maintenance of a permanent establishment, and so on. A country may emphasize on any one or more of the aforesaid factors for exercising fiscal jurisdiction to tax the entity. In the same fashion and depending on which of the factors is considered as the related or connecting factor in different countries, the same income of the same entity might become liable for taxation in different countries. This would give rise to some difficulties and consequently prejudice economic development. To avoid such an anomalous and incompatible situation, the governments of different countries enter into bilateral treaties or conventions for granting relief against double taxation. Such treaties, conventions or agreements are called double taxation avoidance treaties, or conventions.

8. All the treaties signed by different countries are the source of international law and the signatory countries are bound down in their international conduct and relations under these treaties for which nations have different criteria. Nevertheless, the situation regarding those treaties, which effect the subject of countries directly like fiscal treaties the situation is altogether different. It is the reason that for fiscal treaties dealing with double taxation avoidance, different countries have varying procedures. In the United States, such a treaty becomes a part of municipal law upon ratification by the Senate. In the United Kingdom, such a treaty would have to be endorsed by an order made by the Queen in Council. In Pakistan, a treaty would have to be translated into an Act of Parliament, a procedure, which would be time-consuming and cumbersome, therefore a special procedure was evolved by inserting Section 163 in the Ordinance. For the sake of reference, we think it appropriate to reproduce Section 163 of the Ordinance hereunder:

"163. Avoidance of double taxation and prevention of fiscal evasion.- (1) The Federal Government may enter into an agreement with the Government of any country for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income leviable under this Ordinance and under the corresponding law in force in that country, and may, by notification in the official Gazette, make its provisions as may be necessary for implementing the agreement.

(2) where any agreement is made in accordance with sub-section (1), the agreement and the provisions made by notification for implementing the said agreement shall, notwithstanding anything contained in any law for the time being in force, have effect in so far as they provide for-

- a) relief from the tax payable under this Ordinance; or*
- b) determining the income accruing or arising, or deemed to accrue or arise, to non-residents from sources within Pakistan; or*
- c) where all the operation of business or profession are not carried on within Pakistan, determining the income attributable to operations carried on within and outside Pakistan, or the income chargeable to tax in*

Pakistan in the hands of such persons, including their agents, branches or establishments in Pakistan; or

d) determining the income to be attributed to any person resident in Pakistan having any special relationship with a non-resident; or

e) exchange of information for the prevention of fiscal evasion or avoidance of taxes on income chargeable under this Ordinance and under the corresponding law in force in that other country.

(3) The provisions of the Seventh Schedule shall have effect where an agreement provides that the tax payable under the laws of the country concerned shall be allowed as credit against the tax payable in Pakistan.

(4) notwithstanding anything contained in sub- sections (1), (2) and (3) any such agreement may include provisions for relief from tax for any period before the commencement of this Ordinance or before the making of the agreement."

9. It is noteworthy that under the mandate of several treaties of Pakistan with other states, a similar provision is inserted under Section 107 of the Income Tax Ordinance, 2001. Nevertheless, regarding Section 163, in the case reported as **Messrs EFU General Insurance Ltd vs. Federation of Pakistan (2010 PTD 1159)**, a Division Bench of this Court to which one of us i.e. my learned brother Justice Irfan Saadat Khan was a member, as well as the author of the said judgment, has referred an unreported judgment of this Court i.e. I.T.A. No. 297 of 1997, wherein it is held as:

"A plain reading of section 163 of the Income Tax Ordinance is sufficient to hold that existence of a duly executed treaty between the Government of Pakistan and any country would oust the application of the Income Tax Ordinance and provide over-riding effect to the treaty in respect of the matters enumerated in clauses (a) to (e) of subsection (2) of section 163 of the Income Tax Ordinance and avoidance of Rule 20 of the Income Tax Rules, 1986 would be covered by clause (a) of section 163 (2) of the Income Tax Ordinance. The presence of specific clause in the treaty for ousting the application of the Income Tax Ordinance and the rules made thereunder is not a condition or requirement for giving overriding effect to the provisions of the treaty and ousting the application of the Income Tax Ordinance."

10. The applicant has paid a premium to two different non-resident insurance companies, amongst them one is the resident of the United Kingdom and the other is the resident of the United States. Pakistan has signed treaties for the avoidance of double taxation with both of these countries. Now the disputation arises whether the amount of premium paid by the assessee is the subject deduction of income tax or not. Since Pakistan has signed avoidance of double tax treaties with these countries having similar agreed conditions in the treaties. In Articles III(1) of Pakistan and the United States treaty of avoidance of double taxation, it is mentioned as:

"A United States enterprise shall not be subject to Pakistan taxes in respect of its industrial or commercial profits unless it is engaged in trade or business in Pakistan through a permanent establishment situated therein. If it is so engaged, Pakistan tax may be imposed upon the entire income of such enterprise from sources within Pakistan."

11. Similarly, the issue of elimination of double taxation has been dealt with in the treaty between Pakistan and the United Kingdom. In the said treaty or convention, under Article 2 with more details. In paragraph 1 of Article 2, the details of those taxes are mentioned which covers under the treaty, which also includes income tax. The text of paragraph 2 of Article 2 reads as under:

"This Convention shall apply to any identical or substantially similar taxes which are imposed by either Contracting State after the date of signature of this Convention in addition to, or in place of, the taxes referred to in paragraph 1 of this Article. The competent authorities of the Contracting States shall notify each other of any substantial changes which are made in their respective taxation laws."

12. Under Article 5 of Pakistan and the United Kingdom Treaty, it is defined that the Permanent Establishment means 'a fixed place of business through which a business of an enterprise is wholly or partly carried on.' According to the definition, the Permanent Establishment includes a branch, an office, a factory, a workshop, a warehouse, a mine,

building or construction site, etc. Similar definition of a Permanent Establishment is mentioned in Article II(m) of Pakistan and the United State Treaty. Both the treaties do not lay any embargo upon insurance companies. It is also significant that under Article 7 of the Pakistan-UK treaty and Article III of the Pakistan-US treaty renders the income of a non-resident insurance company having a permanent establishment in the United Kingdom and the United States respectively as non-taxable in Pakistan.

13. In view of the definition, it is admitted position that both the insurance companies are non-resident companies and having no permanent establishment in Pakistan, as per the definition in the aforementioned articles of the referred treaties. Both the insurance companies are Permanent Establishment of the United Kingdom and the United States, as such they are squarely covered under the Avoidance to Double Tax Treaties, signed by Pakistan with the countries of their origin. Hence, we are of the view that their income is not liable to the imposition of income tax in Pakistan. Hence, the premium paid by the assessee to those insurance companies is not chargeable to income tax, as such the assessee is not required to deduct tax on the premium paid to those non-resident insurance companies. We, therefore, reply the rephrased question of law in 'NEGATIVE' i.e. in favour of the assessee/taxpayer and against the department.

14. With these observations, the instant income tax reference stands disposed of. Office is directed to send a copy of this order under the seal of the Court to the Registrar, learned Income Tax Appellate Tribunal (Pakistan), Karachi , as required under the law.

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