

IN THE HIGH COURT OF SINDH AT KARACHI

Special Sales Tax Reference Application No.06 of 2019 along with
Special Sales Tax Reference Application Nos.09 to 24, 114, 768 and 811,
812, 813, 814 and 815 of 2019, 768, 114 and 09 of 2019

**Present: Mr. Justice Aqeel Ahmed Abbasi
Mr. Justice Zulfiqar Ahmad Khan**

Date of hearing: 06.09.2021

Applicant: M/s. M. Mubbashir Traders through
Mr. Salman Zaheer Khan, Advocate

Qazi Umair Ali, Advocate in Spl. STRAs
Nos. 811 to 815 of 2019.

Mr. Imtiaz Ali, Advocate in Spl.STRAs
Nos.768 of 2019.

Respondent: Sindh Revenue Board through
Mr. Ghulam Murtaza Korai, advocate

JUDGMENT

Through instant Sales Tax Reference Applications, applicants originally raised 21 questions, which according to their respective counsel, were questions of law arising from the impugned order dated 22.11.2018 passed by the Appellate Tribunal, Sindh Revenue Board, Karachi, however after arguing the matter at some length, in the hearing dated 15.01.2019 the learned counsel requested that only question Nos. VIII, IX and VI be considered by this court, which are answered through the instant judgment. These questions are reproduced in the following:

- I. Whether the Applicant is liable to be registered under the 2011 Act and the Rules made thereunder, since it is not performing any services that may attract the provisions of the 2011 Act?
- II. Whether the nature of transaction of sale and purchase of goods between the Manufacturer and the Applicant, as envisaged under the letter of appointment dated January 05, 2016 (the "Appointment Letter") executed between the Applicant and the Manufacturer, is distinct from the taxable service of "supply chain management or distribution (including delivery) service" as stipulated under tariff Heading 9845.0000 in the second schedule of the 2011 Act?
- III. Whether the learned Appellate Tribunal has misinterpreted and misapplied the Tariff Heading 9845.0000 "supply chain management or distribution

(including delivery) service”, as stipulated under in the second schedule of the 2011 Act?

2. Briefly stated, facts of the case (taken from Spl STRA No.06/2019 as a leading case) are that the applicant is a registered taxpayer engaged in the business of buying and selling of goods, holding a valid NTN. The respondent No. 3 sent a Show Cause Notice dated May 2, 2017 to the Applicant, in terms of which, the Applicant was called upon to show cause as to why it should not to be compulsorily registered under section 24B of the Sindh Sales Tax on Services Act, 2011 (“the 2011 Act”) as it was providing distribution services to the manufacturer named as Colgate Palmolive (Pakistan) Limited (“CPL”). In reply, the applicant took the position that it was not rendering any service including delivery services to CPL in the capacity of its distributor, and for such a tax incidence, the applicant was already registered and paying Federal Sales Tax under the 1990 Act, therefore, the 2011 Act was not applicable to it. Respondent No. 3 did not accept the submissions made by the applicant and passed Order in Original No.86/2017 against the applicant. Being aggrieved, the applicant filed appeal before Respondent No.2 however, the said respondent vide its Order-in-Appeal upheld the Order in Original. After being compulsorily registered under the 2011 Act, the applicant was directed by the Respondent No.4 to furnish records and documentation for its assessment under section 52 of the 2011 Act, vide notice dated October 1, 2018 against which the applicant filed an Appeal before Respondent No.1 on the grounds that the order passed by the Commissioner (Appeals) was bad in law, and on the facts of the case. The Respondent No.1 however rejected the appeal vide the impugned order dated November 22, 2018 passed in Appeal No.8/2018 and connected appeals (including Appeal No. 61/2018).

3. Per learned counsel of the applicants, orders passed by previous forums were illegal, based on misreading of facts and misinterpretation of law as the relationship between the applicant and CPL being regulated

through the appointment letter dated 05.01.2016 proved that the applicant at all material times remained a buyer/purchaser of the goods from the manufacturer/CPL. Per learned counsel, a distribution agreement indicates a long-term relationship between a manufacturer and distributor, who in essence remains a buyer of latter's goods. However, instead of a one-time or a random purchase, the frequency of purchases between a manufacturer and his distributor is regulated and governed through a distribution agreement instead, and in the present case, the applicant does not provide any services to the manufacturer. Per learned counsel, the agreement/appointment letter proves that after purchasing goods, the applicant acquires absolute right/discretion to sell those to any person of its choice. The learned counsel further stated that after buying goods from the manufacturer against sales tax invoices under the 1990 Act, the applicant sells those to wholesalers and retailers, which are the applicant's own customers, and issues sales tax invoices to them in its own capacity under the 1990 Act and if the applicant was to sell goods as an agent of the manufacturer, in that scenario, the manufacturer would have had to directly issue sales tax invoices to each retailer and the wholesaler. Since latter is not the case, therefore, it is clear that the applicant at all material times remained a buyer of the goods and as such, is not providing any service under the Tariff Heading 9845.0000 [supply chain management or distribution (including delivery) service] of the second schedule of the 2011 Act. Learned counsel placed reliance on the judgment reported as PLD 1961 SC 66 where the Apex Court held that the mere fact a person was called distributor cannot exclude him from the category of a wholesale dealer. The learned counsel also referred to an Indian case reported as 1989 PTD 696. The learned counsel next stated that the applicant is already paying taxes under the federal sales tax regime on the taxable supplies of goods made by it, compulsorily registering the applicant under the 2011 Act when applicant is not performing any services, amounts to forcing the applicant to do something which law does not

require him to do, making it a violation of Articles 3 and 4 of the Constitution of the Islamic Republic of Pakistan, 1973. It is prayed that the instant reference application may kindly be accepted, and the questions raised herein may be decided/answered in favor of the applicant.

4. Learned counsel representing the department supported the orders passed against the applicants at different levels and stated that the applicants have miserably failed to prove that the arrangement they had with the respective manufacturers could escape from the definition of Supply Chain Management or distribution etc. services falling under Tariff Heading 9845.0000 and requested that the reference be answered in favor of the department and against the applicant.

5. Heard the learned counsel, perused the material available on record.

6. Before we proceed any further, we find it relevant to have a detailed look at the letter/agreement which created relationship between the applicant and the manufacturer/CPL. Full text of the agreement between these parties is reproduced hereunder:

Messers
M. Mubashir Traders.
Shahdadpur

Dear Sir/s,

We are pleased to appoint you as distributor/s for all products manufactured & traded by the company.

- (1) Your appointment will be effective from 05/01/2016 and will remain in force till it is terminated by the Company at its sole discretion.
- (2) This is understood that no particular territory has been exclusively allotted or assigned to you for marketing, sole and distribution of our products and the Company shall not be bound to limit any area. The company will be entitled to appoint one or more distributors for the same area or may give one or more brands to the same or more distributors as the Company may deemed appropriate.
- (3) (a) The Company gives prompt payment discount if payment(s) are received in advance or within 24 hours of delivery of stocks.
(b) The payments will be made through bank drafts drawn/payable at Karachi, and drawn in the name of the company or deposited in the bank(s) authorized by the company.
- (4) All supplied to you will be invoiced at the rates applicable on the date on which the goods will be dispatched by the Company, Goods once sold will not be taken back. The terms and condition of sale may be altered by mutual consent.
- (5) You shall make advance payments for all the orders placed with the company. IN case of a discrepancy between the value of the order placed and the quantity of goods dispatched, the difference will be adjusted against your next order.

- (6) The Company may, in its discretion, extend to you, credit facilities, on such terms and conditions as it may deemed proper, in which case the Company will have lien on the stock lying with you and the Company's representatives shall be entitled to check the same periodically for which you will extend all reasonable facilities during normal business hours.
- (7) Each of your order shall be subject to acceptance at the Head Office of the Company. Transactions shall be deemed to have been concluded at Karachi.
- (8) You shall use your best endeavors to promote and increase the sale of products. You shall maintain at all times a reasonably adequate stock of the Company's product at your place to ensure prompt deliveries to customers. You shall maintain a sales force and to ensure reasonably frequent visits to potential customers.
- (9) You will place with the Company Security deposit in cash Rs.20000 (Rupees Twenty Thousand Only) which shall be refunded or adjusted against the bills receivable on final settlement, in the event of termination. In the meantime, the funds be available to the company for use at its business operation at its sole discretion and no interest, return or profit shall be payable on such deposit.
- (10) During the term of your distributionship, the Company may accept and execute any direct order received by it from any customer(s)
- (11) No distributors' trade profit will be allowed to you on sales made by the Company direct to Government Departments, Army authorities and Canteen Stores Departments and you shall not be entitled to make any claim, whatsoever, on the Company in respect of such sales made directly by the Company or through any other person or organization.
- (12) Our responsibilities will cease as soon as the goods are handed over to the Railway Authorities or Road Transport service and the Company shall not be liable for any damage or shortage that might occur in transit from our place of supply to the destination. In the event of a breakdown of machinery in or any labour trouble at our Factory, or inadequacy of transport facility or Force Majeure or other causes beyond our control, the existence and sufficiency of which the Company shall be the sole judge, if the Company is not liable to execute any order within stipulated time, you will have no right of claim of any sort whatsoever against the Company in respect of non-delivery of goods to you with the stipulated time.
- (13) Should you, in our opinion, fail to maintain an increase the sales of our goods or this arrangement be found unsatisfactory or should you fail to make payments against the goods ordered by/dispatched to you or commit any breach of terms and conditions mentioned herein, the Company reserve the right to cancel this Letter of Appointment at any time without notice. The Company shall be the sole judge as to whether your work and/or this arrangement is satisfactory or not.
This Letter of Appointment cancels all previous letters and arrangements, if any, in writing or otherwise and an existence between you and the Company for the sale of our products and our right and obligation under the cancelled arrangement will remain enforceable against you.
- (14) You will submit to the Company daily, weekly, fortnightly and / or monthly stock reports as may be required by us from time to time.
- (15) If any stock of the Company's products or lying unsold with you at the time of termination of your Appointment, these will be taken back at the discretion of the Company, in partial settlement of your account, provided these are in saleable condition. Further the value of these stocks, adjustable against your outstanding will be net of Sales Tax, Excise Duty and other dues including transport and miscellaneous expenses to be incurred.
- (16) In the event of any dispute arisen out of these Presents either as to the construction, meaning or interpretation thereof or of the rights and liabilities of the parties or the performance or non-performance thereof, or as to any matter of whatsoever nature, touching or pertaining these Presents, such dispute, litigation or difference of opinion shall first be referred for arbitration to Sole Arbitrator, to be appointed by mutual consent. Resort to arbitration shall precede any other legal proceeding shall be governed by the laws of Islamic Republic of Pakistan and jurisdiction shall lie in the Honourable Court of Sindh.
- (17) This Appointment Letter does not authorize you to act an Agent, Partner or Sole Distributor. As such it does not authorize you to pass on the benefit of this Letter of Appointment to any other person, organization or enterprises by sub-letting or sale for any consideration or otherwise.
- (18) The arrangements made with you for the sale of the Company's products shall not be assignable transferable.
- (19) You will be entitled to appoint your staff at your risk and costs to promote and organize the sale of the Company's product and for which the Company will not be responsible in any manner.
- (20) To comply with any rules, regulations and by laws framed by the Government from time to time or any legal requirements, the Company will be entitled to make such changes as may be necessary from time to time in the Letter of Appointment.

7. As it could be seen, the applicant was appointed as a distributor and not as an end-user/customers of the goods of the manufacturer meaning thereby the applicant becomes a part of the supply chain flowing from the manufacturer to the end-users or customers. The assertion of the learned counsel that after purchasing the goods the applicant becomes absolute owner thereof has been challenged at all forums. The Order in Original treated this arrangement as one of distribution/supply chain and held that *“M/s. M. Mubbashir Traders receive a consideration in the form of trade discount which the Principal offer and pay to them for rendering all such services and carrying out all these activities in the time and manner prescribed in the agreement. Such a trade discount, being the consideration, is given as percentage of the invoice price on items to item basis. The person is not independent in his actions and all such activities relating to distribution and door to door delivery of goods/ products of M/s. Colgate-Palmolive (Pakistan) Ltd, are completely regulated by the terms and conditions set out in the agreement which also negates the contention of the person that they are the owner of the goods/products and act independently for the trade of goods and products. Even they are bound to follow the company’s policies and directives in connection with the distribution of their products in given territory. It’s their obligation to protect and promote the name/brand and interests of the Principal. The above position explicitly show that M/s. M. Mubbashir Traders is engaged in providing or rendering taxable services of distribution for M/s. Colgate-Palmolive (Pakistan) Ltd for which they receive consideration in the form of discounts, bonuses or trade margins. Even their decisions of passing on the commission amount, offering discounts and bonuses to customers/ clients, retailers and wholesalers are influenced by the terms of agreement. The company continuously monitors the progress of the distributor and may cancel the contract in case of unsatisfactory performance which also shows that they do not independently. The company facilitates the person to take back the saleable stock if contract*

is cancelled. The person cannot sublet the activities or pass the benefit of the contract to any other person. The contract is alterable in order to fulfill any legal requirements. Moreover, any dispute arising during the execution of the contract is subject to arbitration by the Arbitrator or the High Court of Sindh. The abovementioned facts of the case unambiguously show that M/s. M. Mubbashir Traders is doing all activities for and on behalf of M/s. Colgate-Palmolive (Pakistan) Ltd against a certain consideration, hence providing or rendering services as distributor. Moreover, such services are taxable services under second schedule to SST Act, 2011 @ 13 % of the value of services”.

8. The Order in Appeal, in connection with the relationship between the parties emanating from the above quoted agreement/appointment letter observes “*Now, if these meaning are read with the facts and circumstances of the instant case, it will be understood that the transaction involved comprises of the activities more than the mere activities of distribution or the delivery services. And the nature of transaction in hand can be determined by the terms and conditions of the Agreement which is evident and is explanatory of the same. In other words, the spirit underlying the value addition is founded on the fact that the appellant providing or rendering services as a distributor are not self-consumed and the services are rendered or delivered in furtherance of an activity in a supply chain management. The Appellant is to act as a distributor and to use its facility to store the products on behalf of the Manufacturer and further the Appellant has to use its resources for delivery and distribution of the product to the market level....furthermore, it is to be seen that the transaction involved comprises of two ends. One is the end of provision of service and the other is the distribution of goods to market. And further fact is that the trade discount is given to the Appellant by the Manufacturer. In this regard the sample sales invoices provided by the Appellant have been examined and perused. As already established above, the role of the Appellant is that of an intermediary/distributor. And*

for performing and acting as such the Appellant is providing or rendering services to the Manufacturer who is consumer of services and the market entities are the receiver of products. Thus, factually, the burden of consideration/trade discount has been passed onto the end consumer of the service (i.e. the Manufacturer). The services and their value can also be quantified in the shape of discount granted by the service recipient (i.e. the Manufacturer). As a matter of fact even after the deduction of trade discounts, the service recipient (i.e. the Manufacturer) has a certain margin of interest over the marketable price. And in such a case the Appellant is liable to charge the tax on services over and above the discounted price; it will be the service recipient (i.e. the Manufacturer) who bears the burden for being the recipient of services. And as a result of this arrangement, the profit margin of the service recipient (i.e. the Manufacturer) may reduce but the price of the product will neither increase nor the end consumer of product suffer, therefore, no disharmony may be due to price fixation by the Act-1990”.

9. The Tribunal in its impugned order has also held that “*even if it is considered that on payment of consideration by the appellant the goods become its property and ownership along with risk and reward transferred to the appellant one thing is clear that the appellant cannot exercise full control over the goods and is bound by the instruction of CPO regarding sale, fixing of price and the area in which the goods are to be sold. In this case, the appellant as distributor acquired goods against cash consideration or credit for supplying to the wholesalers or retailers and in this way he supplied goods of its principal against fixed margin....From the contents of the agreements produced before us the substance of the same appears to facilitate sale and delivery of goods and not simple sale of goods....*”

10. In our view, in addition to the modes adopted by the supra forums, relationship between the parties as knitted through the above quoted appointment letter can also be analyzed under the “doctrine of the exhaustion of rights after first sale”. The said doctrine means that an owner of a particular good ceases to have control over further sale of his goods once he has made a valid transaction of sale. It is usually considered as a litmus test in the cases of intellectual property rights. However, the same ratio could also be used in all such cases where a court has to examine residual effect of a sale agreement. In a typical sale of goods agreement, upon receipt of considerations, the seller assures delivery of goods in the hands of the buyer, however at certain times the seller is also made responsible to provide for warranties. Other than that, usually such agreement is a close-end arrangement where buyer is free to use, sell, lend or even abandon or destroy the goods if found unfit for the purpose. If, however, there appears that even after the first sale, the seller retained power to exercise control over the goods, the doctrine of exhaustion of rights becomes an instrument to microscopically analyze such relationship.

11. In the current case, when the applicant claims that it has made full and final payment for the goods and has received possession thereof, one cannot fail to observe that even after that sale, the seller (as in clause 8 for example) has retained right to check that the buyer has sufficient resources for re-sale of the goods. The arrangement also casts duty on the applicant “to make endeavors to promote and increase the sale of products and to maintain at all times a reasonably adequate stock of the goods at its place to ensure prompt deliveries to the customers, and be vigilant to look for potential customers”. The Sale of Goods Act, 1939 only permits seller’s rights on the goods through sections 46 and 47 where the seller could have a lien on the goods if part of the consideration remained unpaid, which is not the case at hand as the applicant claims that there is no lien of the manufacturer on the goods as it has made full payment in

advance. We therefore do not see the arrangement between the parties as a typical sale/purchase one and clearly the applicant is mandated to perform some services for the benefit of the manufacturer even after making full and final payment. This is exactly where the definition of the term “service” comes handy which as defined by the 2011 Act, is to mean *“anything which is not goods and to include but not be limited to the services listed in the First Schedule of the said Act”*. Explanation-I to this definition clause clarifies that a service shall remain and continue to be treated as service regardless of whether the providing thereof involves any use, supply, disposition or consumption of any goods either as **an essential or as an incidental aspect of such providing of service**. Hence the stance of the applicant that it pays sales tax on the goods *per se* (under the 1990 Act) does not qualify him for any credit under the 2011 Act.

12. Coming back to the relationship established between the parties through the aforementioned agreement/letter, even if it is considered that on full payment of consideration by the applicant the goods become its property and ownership along with risk and reward is transferred to it, it is however clear from the above relationship that the applicant is restricted from exercising full control over the goods and is bound by further instructions of CPL (which do not relate to warranty or after sale service). From the contents of the agreement it becomes clearer that the arrangement between the parties, while aims to facilitate sale and delivery of goods to the consumers, leaves a residual element of control of the manufacturer on the goods which is exercised through the hands of the applicant, which clearly does not fit the regime of a classical sale of goods agreement.

13. We are also cognizant of the legal position that while construing a document, whole document is to be read and be considered to ascertain the scope and object of the document. In other words, for determining the

true purpose of a document, one must look into its substance and not the form. In the case of Kamran Industries v. Collector of Customs (PLD 1996 Karachi Page 68) divisional bench of this court has held that "a statute/instrument/document is to be read as whole, and an attempt has to be made to reconcile various clauses for a rationale meaning, while avoiding redundancy to any part thereof". In the other reported judgment in the case of Habib Insurance Limited v. Commissioner of Income Tax (Central), Karachi (PLD 1985 Supreme Court Page 109), it has been held that "...in Revenue cases one must look at the substance of thing and not at the manner in which the account is stated". In the presence of these precedences, when the doctrine of exhaustion of rights seems to indicate that the seller is still exercising rights over the goods, one cannot hold that the present arrangement is devoid of any element of service provided by the applicant to foster the aims and objects of the manufacturer through the applicant's hands. We therefore cannot oblivate from our minds that some service is performed by the applicant aimed to give a value-add to the manufacturer's profitability.

14. Now coming to the case law cited by the learned counsel for the applicant viz Pakistan through the Secretary Ministry of Finance, Government of Pakistan, Karachi v. Popular Tobacco Co., Karachi (PLD 1961 SC 66), *ipso facto*, we do not see any relevance of the said judgment with the facts and circumstances of the present case. In the cited case, the question before the Hon'ble Supreme Court was that at what value Excise Duty be charged under Central Excises and Salt Act, 1944, as there was a dispute that it should be charged at wholesale price rather than the gate-out price of the manufacturer. Our Lords held that the intention of the legislature was that excise duty should be paid at the prices actually received by the manufacturer and not on the retail value of the goods, considering that in the distribution chain, discounts are usually given to wholesalers and distributors. With regards to the other case law cited by learned counsel being *Alwaye Agencies v. Deputy Commissioner*

of Agricultural Income-Tax and Sales-Tax, Ernakulam (1989 PTD 696), the question before the Supreme Court of India was as to whether tax would be imposed on the assessee for the goods directly sent by the manufacturers to the consumers falling within the distributorship region of the applicant. After detailed analysis of the relevant provisions of the law considering the nature of agreement between the parties and in the light of surrounding circumstances, court held that the assessee as distributor was not an agent of the company in respect of the transaction in question but was a purchaser, hence the transactions were liable to be included in the turnover of the assessee. We are also not impressed with this citation also.

15. The foregoing position of law makes it clear in our minds that the nature of transaction of sale/purchase of goods between the manufacturer and the applicant established through the agreement/appointment letter aims to propel a service performed by the applicant which could rightly fall under the head of "supply chain management/ distribution (including delivery) service", hence attracts the provisions of the 2011 Act, and the Tribunal did not misinterpreted or misapplied the relevant tariff heading 9845.0000 to the case of the applicant. Resultantly Question Nos. I and II are answered in **Affirmative** and the Question No. III is answered in **Negative**.

Judge

Judge

Karachi, 10/09/2021

Barkat Ali, PA