IN THE HIGH COURT OF SINDH
AT KARACHI

Suit No.2250 of 2016

Plaintiff	:	M/s. UIG (Pvt) Ltd, through Umair Ahmed Qazi, Advocate.
Defendants No. 2, 3 & 5:		Member Inland Revenue (Sales Tax) and others, through Waqar Memon, Advocate
Defendant No. 4	:	Sindh Revenue Board through, Javed Ali Sangi advocate
Date of hearing	:	09.02.2024, 22.02.2024, 15.04.2024 & 07.10.2024.

JUDGMENT

YOUSUF ALI SAYEED, J - The Plaintiff is the proprietor of a hotel chain under the name 'Ramada Plaza', with the matter arising for determination through this Suit relating to whether the levy of sales tax on the business of hotels and restaurants is a subject that falls within the Federal or Provincial domain, and whether the supplies made during the course of such business are taxable under the Sales Tax Act, 1990 or the Sindh Sales Tax on Services Act, 2011 (hereinafter referred to as the "**Federal Statute**" and "**Provincial Statute**" respectively).

2. That question has been raised in the wake of a Show Cause Notice bearing No. OIR/Unit-02/Zone-II/LTU-II/2016 dated 04.10.2016 (the "**SCN**") issued to the Plaintiff by the Officer Inland Revenue with reference to the provisions of the Federal Statute, treating the sale of food and beverages for the tax years 2012-13, 2013-14 and 2014-15 as the sale/supply of taxable goods chargeable with sales tax under that enactment.

3. The case advanced by the Plaintiff turns on Entry 49 of the Federal Legislative List, Part I in the Fourth Schedule to the Constitution of Pakistan, as amended through the 18th Amendment by the addition of the words "except sales tax on service", so as to render a "sales tax on service" a provincial subject, with the Provincial Statute then having been promulgated so as to levy a sales tax on the economic activities that constitute a "taxable service" within the contemplation of Section 3 thereof. Per the Plaintiff, the food and beverage business falls within the scope of "services provided or rendered by restaurants", as encompassed under the Provincial Statue, and is not a supply of goods giving rise to a 'taxable activity' or 'taxable supply' for purpose of the Federal Statute. It is contended that the matter thus falls within the Provincial domain and the jurisdiction of the Sind Revenue Board ("**SRB**") rather than the Federation and its instrumentalities, such as the Federal Board of Revenue ("**FBR**"), which lacks the competence to demand or collect such a levy. As such, it has been prayed *inter alia* that this Court be pleased to:

"(a) Declare that the Plaintiff's business fall within the ambit of service as contemplated under Section 2(79) of the Sindh Sales Tax on Services Act, 2011 and that the Plaintiff falls within the definition of restaurant as prescribed under the Sindh Sales Tax on Services Act 2011;

(b) Declare that the Plaintiff is not obligated to pay sales tax on supplies of taxable goods as the same now falls within the purview of the province of Sindh;

(c) Declare that the Impugned Show Cause Notice bearing No Show Cause Notice bearing No. OIR/Unit-02/Zone-II/LTU- II/2016 dated 4.10.2016 is unlawful, illegal and unconstitutional and of no legal effect;

(d) Set aside / quash Impugned Show Cause Notice issued by Defendant No.3;

(e) Permanently restrain and prohibit Defendants / their officers from taking any action against the Plaintiff on the basis of Impugned SCN.

4. Thorough their written statement, the functionaries of the FBR rebutted the Plaintiff's contentions so as to reiterate the demand raised through the SCN whilst submitting that the Plaintiff was engaged in two types of business, one being the rental of rooms and the other the supply of food and beverages through its restaurants. While it was accepted that the former was a service, the latter was said to constitute the manufacture and sale of goods, with it being contended that the same was a Federal subject and that the FBR was accordingly empowered to collect sales tax on the supply thereof.

5. Conversely, the SRB supported the case of the Plaintiff and submitted in its written statement that the SCN had been rightly challenged as an encroachment as it was only the SRB that had jurisdiction to charge, levy and collect sales tax on services under the post 18th Amendment regime, and that necessary clarifications had also been issued in that regard in order to avoid the issue of double taxation.

6. From an examination of the pleadings, the following issues came to be framed by consent on 01.06.2023:

> "1. Whether the business of Hotels and Restaurants will fall within the ambit of Sindh Sales Tax on Services Act, 2011 or Federal Government and Defendants No.2 and 3 can demand and recover taxes from the Plaintiff?
>
> 2. What should the decree be?"

7. As the core issue is grounded purely in law, the matter proceeded directly to arguments.

8. Advancing their submissions, learned counsel for the Plaintiff and SRB argued that the Plaintiff's business for the purposes of the levy of sales tax on services fell within the ambit and purview of the term "service" as provided under Section 2(79) of the Provincial Statute, and classified under Tariff Heading 9801.2000 in the First Schedule thereof. He referred to a letter dated 04.03.2009 issued by the Second Secretary (FE), Inland Revenue Wing, Federal Board of Revenue (Revenue Division), as well as letter C. No. 1(3)FED/2007 dated 25.07.2009 emanating from the FBR and yet another letter bearing No. SRB-STM-3-4/48 addressed by the Member (L&C) to the Member (Inland Revenue), Federal Board of Revenue, to point out that the same acknowledged and clarified that the business of restaurants constituted a service. It was argued that the SCN was misconceived and bad in law as the business of the Plaintiff could not be split into supply of goods and services and that after the 18th Amendment levy of sales tax on services was a subject that fell exclusively in the Provincial domain.

9. Conversely, learned counsel for the FBR fell back on the written arguments submitted in the matter in consonance with the pleaded stance that the running of a restaurant entails the a process of manufacture where many raw materials are mixed, cooked and converted into final food items, constituting distinct products where the ingredients do not remain traceable, and the mere presentation of such food items by a restaurant owner to its customers at its premises did not change or take away such status of manufacture or detract from the applicability of the Federal Statute.

10. Having heard and considered the arguments advanced in light of the material on record, it merits consideration that by virtue of Entry 49 of the Federal Legislative List, Part I in the Fourth Schedule to the Constitution of Pakistan, as amended through the 18th Amendment by the addition of the words "except sales tax on service", the subject of levy of a sales tax on any service falls squarely within the provincial domain and the Provincial Statute having been promulgated accordingly. Indeed, no cavil was raised in that regard on behalf of the FBR, with the case advanced on its behalf being predicated on the assertion that the Plaintiff restaurant business was not a service, but amounted to the manufacture and sale of goods. The scope of the determination to be made in the matter thus stands circumscribed accordingly.

11. In that regard, it is discernible that the Section 2(79) of the Provincial Statute defines the terms “service” as follows:

> 2(79) "service" or services means anything which is not goods or providing of which is not a supply of goods and shall include but not limited to the services listed in the First Schedule of this Act.
>
> Explanation: - A service shall remain and continue to be treated as service regardless whether or not the providing thereof involves any use, supply or consumption of any goods either as an essential or as an incidental aspect of such providing of service;

12. The services provided or rendered by restaurants have been classified under Tariff Heading 9801.2000 in the First Schedule of the Provincial Statute, with the term "restaurant" being defined under Section 2(74) thereof to mean:-

> 2(74) "restaurant", by whatever name called, includes a person, establishment, organization, place, café, coffee houses or ice cream parlors where food, beverages or other edible preparations are sold or served to the customers, including the customers availing of the take away service or delivery service or room service or catering service, whether or not the restaurant provides any other service, facilities, utilities or advantages.

13. As such, it is manifest that the Provincial Statute treats the business of restaurants to be a service. Even otherwise, through the letter dated 04.03.2009 issued by the Second Secretary (FE), Inland Revenue Wing, Federal Board of Revenue (Revenue Division) it was earlier clarified as much, with it having been stated that "the issue has been examined in the Board and it is clarified that since the services provided by hotels and restaurants are included in Chapter 98 of the First Schedule to the Customs Act, 1969, the same are not be liable to Special Excise Duty." Furthermore, vide the FBR's letter C. No. 1(3)FED/2007, dated 25.07.2009 it was clarified that "as the business of hotels and restaurants is classified as "services" and the SED is required to be levied on goods produced, manufactured or imported into Pakistan. Hence the services provided by the Hotels and Restaurants do not come in the definition of goods produced, manufactured, as such the SED is not liable to be levied of the Services provided by the Hotels and Restaurants", whereas the letter bearing No. SRB-STM-3-4/48 addressed by the Member (L&C) to the Member (Inland Revenue), Federal Board of Revenue mentioned that "*FBR may kindly exempt the Federal Sales Tax on services provided by the restaurants which will remove all possible doubts, disputes, ambiguities, litigation and will also avoid double taxation. The issue needs to be accorded top priority as continued ambiguity or confusion in this regard will cause loss of revenue to the exchequer and undue benefits to these service providers taking refuge behind the jurisdiction related issues.*"

14. For its part, the SRB also issued a clarification on 22.02.2012 in respect of restaurants, wherein it was mentioned *inter alia* that:

"**CLARIFICATION REGARDING SINDII SALES TAX ON SERVICES PROVIDED OR RENDERED BY RESTAURANTS (TARIFF HEADING 9801.1000),**

Consequent upon the 18 Amendment in the Constitution of Islamic Republic of Pakistan (specifically, in relation to item No 49 of the Fourth Schedule thereof) and Article 8 of the 7th NFC Award, the Government of Singh, exercising the powers conferred by Article 142(c) of the Constitution, has enacted and promulgated the Sindh Sales Tax on Services Act, 2011 (Sindh Act No. XII of 2011), which has taken effect from 01-07-2011. The services described in the Second Schedule to the said 2011- Act are "taxable services" liable to Sindh sales tax in terms of section 3 thereof. The services provided or rendered by restaurants, classified under tariff heading 9801.2000 of the Second Schedule to the said 2011-Act, are "taxable services" liable to Sindh sales tax at 16%. The persons providing or rendering such restaurant services are required to get thereselves registered / enrolled with SRB under section 24 of the sail 2011-Act and to pay the Sindh sales also to e-file the prescribed monthly tax return (SST-03) under Section 10 thereof read with rules 12, 13, 14 and 42 of the Sindh Sales Tax on Services Rules, 2011.

A news item has appeared in a section of the Press that there is some dispute or confusion between FBR and SRB regarding the jurisdiction of collection of sales tax on the foods and drinks served in restaurants in Sindh. The aforesaid Constitutional and legal provisions make it sun-unambiguously and unequivocally clear that the services provided or rendered by restaurants in Sindh are liable to Sindh sales tax under tariff item 9801.2000 of the Second Schedule to the Sindh Sales Tax on Services Act. 2011. Only such restaurants whose annual turnover from the service of food items does not exceed Rs. 3.6 million from all its outlets in Sindh are not required to register with SRB in terms of rule 42 (1)(a) of the said 2011-Rules.

It is pertinent to mention that vide its letter C. No. 1 (3) FED/2007 dated 25.07.2009, the FBR circulated the following opinion dated 27-06-2009 of the Law & Justice Division Islamabad, amongst all its field formations for further necessary action:-

"5. The business of hotels and restaurants is classified as services which concept is quite distinct from excise duty which is leveled and collected on goods produced or manufactured. The subject or services does not figure in either the Federal Legislative List or the Concurrent Legislative List In the Fourth Schedule to the Constitution of the Islamic Republic of Pakistan; it falls within the Provincial legislative field. The Special Excise Duty referred to under section 3A of the Federal Exercise Act, 2005, is leviable on goods produced or manufactured in Pakistan and the goods imported into Pakistan. From language of the aforesaid section it is clear that the aforesaid (SED) is not leviable on services rendered by hotels and restaurants".

In view of the settled Constitutional and legal position, stated above, all restaurants providing or rendering taxable services of tariff heading 9801.2000 in Sindh are advised not to be misguided or misled by any un-authorized advice/report. No Agency, other than the SRB, is authorized to administer, regulate, collect or receive the Sindh sales tax on any of the taxable services provided or rendered in or from Sindh."

15. The legislative competence to levy a tax on 'services' was examined by a learned Division Bench of this Court through a Constitutional lens in the case reported as Pakistan International Freight of Forwarders Association through General Secretary v Province of Sindh through Secretary and another 2017 PTD 1, where it was observed that:

> 58. In our view, the "exception" added to entry No. 49 is not a "true" exception. Rather, it is an independent provision in its own right. It has two primary effects. Firstly, and most importantly for present purposes, it recognizes expressly on the constitutional plane that a taxing power in respect of the taxing event of rendering or providing of services vests in the Provinces. The crucial question is whether or not this power is exclusive to the Provinces. It has been noted above that in the scheme of the present Constitution, the same taxing event cannot simultaneously vest in two legislatures. For that to happen would mean that the taxing power is also the same. It has also been noted that the constitutional scheme does not envisage a sharing of a taxing power. The Constitution recognizes a division of a taxing power and that is all. In our view, both of these principles are fully attracted and applicable here. The real effect of the "exception" is to "shift" the taxing power in relation to the taxing event of rendering or providing of services from the Federation to the Provinces. As has been noted above, in our view this power had earlier vested solely in the Federation by reason of the First Ratio of the Hirjina judgment, as applied to the 1973 Constitution. This was a decision of the Supreme Court operating on the constitutional plane. It follows that its effect could only be displaced or overridden by a constitutional amendment and nothing else. It is for this reason that it was necessary to recognize the taxing power of the Provinces expressly on the constitutional plane; anything less could not possibly have altered the effect of the Hirjina judgment. What the "exception" has done is that it has not simply recognized that "a" taxing power in respect of the taxing event of rendering or providing of services vests in the Provinces. Rather, it has established that "the" said taxing power in respect of the said taxing event now vests solely in the Provinces. It is of course immaterial that when the power vested in the Federation it manifested as a duty of excise, while on its "shift" or "transfer" to the Provinces it manifests as a sales tax. As is well

established, it is the substance and not the form (and certainly not the label) that is of importance in fiscal matters. The "exception", being an independent provision in its own right thus has the effect of overriding the First Ratio of Hirjina in relation to the present Constitution. It is almost as if the premise of the Second Ratio has now been given effect, shorn of the peculiar features that had attended the premise in the context of the 1962 Constitution. So divested, the premise of the Second Ratio, i.e., that the Provinces alone can exercise the taxing power, now holds the field.

59. The second effect of the "exception", though not directly relevant for present purposes, may also be adverted to. Entry No. 49 is concerned with, inter alia, the sale of goods. The taxing power in relation thereto vests solely in the Federation. The taxing power in relation to the rendering or providing of services now vests solely in the Provinces. However, in the real world, transactions and events cannot be divided so neatly and placed in watertight compartments, one relatable solely to goods and the other to services. There are many transactions that have elements of both. The point can be illustrated with a simple example, which was in fact discussed threadbare during the course of submissions. Consider a restaurant, and for convenience suppose that it is a pizza restaurant. A family goes and has a meal at the restaurant. Is that a service or a sale of goods? Most would say that it is the providing of a service and taxable only by the Province, even though it clearly has elements of a "transfer" of "goods" (the pizza consumed by the family). Now vary the facts slightly. Suppose the family goes to the restaurant and finds that there is a long waiting time. Rather than wait, it does a "takeaway", i.e., it orders the pizza but has it packed for taking away and does not eat it in the restaurant. Is that a service or a sale of goods? Most would say that this is a sale of goods, taxable only by the Federation. Vary the facts again. Suppose that the restaurant offers a home delivery service, and the family rather than eating out simply orders a pizza for delivery at home. Is that a sale of goods alone, or a sale transaction coupled with the "service" of home delivery? If the latter, which element is determinative, that of the goods or the service? Or is it that each of the Federation and the Province can separately tax its own element? As this simple example shows, the boundary between a "pure" sale of goods and "pure" service event and a "hybrid" transaction is fluid and may, on occasion, be surprisingly difficult to determine. That this is so is indicated by the fact that these points have had to be considered at the highest levels in other jurisdictions, albeit in contexts rather different from those at hand. Reference may be made, e.g., to Dr Beynon and Partners v. Customs and Excise Commissioners [2004] UKHL 53, [2004] 4 All ER 1091, a decision of the House of Lords and Card Protection Plan Ltd v Customs and Excise Commissioners (Case C-349/96) and Faaborg-Gelting Linien A/S v Finanzamt Flensburg (Case C-231/94), decisions of the European Court of Justice. (The latter decision, incidentally, involved meals at restaurants.)

> 60. The importance of placing the "exception" in entry No. 49 now becomes even more apparent. The 1973 Constitution of course always lacked an enumeration of those legislative powers that vested exclusively in the Provinces. A taxing power was now, in part, being "shifted" from the Federation to the Provinces. In order to give it express recognition in the Constitution, it had to be placed somewhere in the text. The nature of the power (and in particular the taxing event being "shifted", i.e., the rendering or providing of services) was such that it would inevitably interact with the exclusive taxing power that vested in the Federation in relation to the sale of goods. What could be better then, than to place the Provincial power in juxtaposition to the Federal power, where it would emphasize both the exclusiveness of each power and yet recognize that the scope and extent of the powers would have to be properly balanced, reconciled and resolved in such manner that allowed each to operate in its own field and yet in harmony. It should be kept in mind that such an exercise, while relatively new to the 1973 Constitution, is well established in those constitutions, such as Canada and India, where there are powers exclusively enumerated for each legislature. The principles enunciated in terms of those Constitutions will, no doubt, now be explored, considered and developed by our Courts in relation to entry No. 49.

16. In the same case, the learned Division Bench then went on to hold that:

> 64. The position that emerges can therefore be stated as follows. The power to levy a tax on the providing or rendering of services vested exclusively in the Federation from the commencement day (14.08.1973) till the coming into force of the 18th Amendment (19.10.2010). Thus (as presently relevant), the 1944 Central Act validly continued as an existing law in the Federal domain, and the 2005 Federal Act was validly enacted by the Federation. The 2000 Provincial Ordinance trenched directly upon the Federal field and was therefore ultra vires the Constitution. With effect from 19.10.2010, the power to levy the tax vested exclusively in the Provinces, but by reason of clause (7) of Article 270AA, the Federation continued (insofar as this Province is concerned) to have the competence to collect the excise duty till 30.06.2011. When the 2011 Provincial Act came into force on 01.07.2011, those provisions of the 2005 Federal Act that related to the levy of excise duty on the rendering or providing of services became ultra vires the Constitution. (It could perhaps be said that those provisions became ultra vires on 19.10.2010 and ineffective on 01.07.2011. However, nothing really turns on this distinction.) Thereafter (but subject to what is stated below), it was only the Province that could validly levy the tax on services.

17. In the decisions of the European Court of Justice in the case of Faaborg-Gelting Linien A/S v Finanzamt Flensburg (Case C-231/94) [1996] ECR 1-2395, 2411-2412, concerning the classification of restaurant meals, as relied upon by the learned Division Bench in Freight Forwards (Supra), the following principles were laid down:

> "12. In order to determine whether such transactions constitute supplies of goods or supplies of services, regard must be had to all the circumstances in which the transaction in question takes place in order to identify its characteristic features.
>
> 13. The supply of prepared food and drink for immediate consumption is the outcome of a series of services ranging from the cooking of the food to its physical service in a recipient, whilst at the same time an infrastructure is placed at the customer's disposal, including a dining room with appurtenances (cloak rooms, etc.), furniture and crockery. People, whose occupation consists in carrying out restaurant transactions, will have to perform such tasks as laying the table, advising the customer and explaining the food and drink on the menu to him, serving at table and clearing the table after the food has been eaten."

18. In Indian Hotels Company Ltd. and Others v. The Income Tax Officer, Mumbai and Others AIR 2000 Supreme Court 2645, it was observed *inter alia* that:

> " ... The foodstuff prepared by cooking or by any other process from raw materials such as cereals, pulses, vegetables, meat or the like cannot be regarded as commercially distinct commodity and it cannot be held that such foodstuff is manufactured or produced."

19. Similarly, in The State of Punjab v. Associated Hotels of India Ltd. MANU/SC/0570/1972, it was observed by the Supreme Court of India while considering the nature of the hotel/hospitality industry that:

> "15. ... No doubt, the customer, during his stay, consumes a number of food stuffs. It may be possible to say that the property in those food stuffs passes from the hotelier to the customer at least to the extent of the food stuffs consumed by him. Even if that be so, mere transfer of property, as aforesaid, is not conclusive and does not render the event of such supply and consumption a sale, since there is

no intention to sell and purchase. The transaction essentially is one of service by the hotelier in the performance of which meals are served as part of and incidental to that service, such amenities being regarded as essential in all well conducted modern hotels. The bill prepared by the hotelier is one and indivisible, not being capable by approximation of being split up into one for residence and the other for meals. No doubt, such a bill would be prepared after consideration of the costs of meals, but that would be so for all the other amenities given to the customer. For example, when the customer uses a fan in the room allotted to him, there is surely no sale of electricity, nor a hire of the fan. Such amenities, including that of meals, are part and parcel of service which is in reality the transaction between the parties.

16. Even in the case of restaurants and other such places where customers go to be served with food and drink for immediate consumption at the premises, two conflicting views appear to prevail in the American courts. According to one view, an implied warranty of wholesomeness and fitness for human consumption arises in the case of food served by a public eating place. The transaction, in this view, constitutes a sale within the rules grwing rise to such a warranty. The nature of the contract in the sale of food by a restaurant to customers implies reliance, it is said, on the skill and judgment of the restaurant-keeper to furnish food fit for human consumption. The other view is that such an implied warranty does not arise in such transactions. This view is based on the theory that the transaction does not constitute a sale inasmuch as the proprietor of an eating place does not sell but "utters" provisions, and that it is the service that is predominant, the passing of title being merely incidental Corpus Juris Secundum, Vol. 77, 1215-1216. The two conflicting views present a choice between liability arising from a contract of implied warranty and for negligence in tort, a choice indicative of a conflict, in the words of Dean Pound, between social interest in the safety of an individual and the individual interest of the supplier of food. The principle accepted in cases where warranty has been spelt out was that even though the transaction is not a sale, the basis for an implied warranty is the justifiable reliance on the judgment or skill of the warrantor and that a sale is not the only transaction in which such a warranty can be implied. The relationship between the dispenser of food and one who consumes it on the premises is one of contractual relationship, a relationship of such a nature that an implied warranty of wholesomeness reflects the reality of the transaction involved and an express obligation understood by the parties in the sense that the customer does, in fact, rely upon such dispenser of food for more than the use of due care. (see Cushing v Rodman 104 Amer L.R. 1023; 82 T.R. 2 Srs. 864. A representative case propounding the opposite view is the case of F. W. Woolworth Co. v. Wilson 74 F.R. 2 Srs. 439, citing Nisky v. Childs Co, 103 N.). Law

464, wherein the principle accepted was that such cases involved no sales but only service and that the dispenser of food, such as a restaurant or a drug store keeper serving food for consumption at the premises did not sell and warrant food but uttered and served it and was liable in negligence, the rule in such cases being caveat emptor.

17. ...

18. The transaction between a hotelier and a visitor to his hotel is thus one essentially of service in the performance of which and as part of the amenities incidental to that service, the hotelier serves meals at stated hours. The Revenue, therefore, was not entitled to split up the transaction into two parts, one of service and the other of sale of food stuffs and to split up also the bill charged by the hotelier as consisting of charges for lodging and charges for food stuffs served to him with a view to bring the latter under the Act.

20. In the same vein it was observed in Commissioner of Income Tax v. S.P. Jaiswal Estates (P.) Ltd. MANU/WB/0147/1992 that:

16. Apart from meals, a hotel provides entertainment and various personal services, with halls for drinking, dancing, exhibitions and group meetings with shops having both inside and street side entrances and offering for sale items such clothes, gifts, candy, theatre tickets, travel tickets. These are also ancillary activities, but do not fall in the activity of manufacture or production. The basic ingredient of hotel-keeping is providing lodging or maintaining a building consisting of many rooms for overnight accommodation which has nothing to do with any manufacturing or producing article or thing.

17. ...
18. ...
19. ...

20. ....Therefore, even if the incidental activity of processing food materials into edible products for service to clients in the restaurant is a necessary adjunct of the hotel business, it is the ultimate nature of the business of hotel-keeping that is determinative of the issue."

21. In view of the foregoing it is apparent that the supply of food and beverages by the Plaintiff through its restaurants constitutes a service in terms of the Provincial Statue, chargeable with sales tax thereunder, and falls beyond the pale of the Federal Statute and purview of the FBR, with the main issue framed for determination being answered in such terms and the Suit being decreed accordingly.

JUDGE