IN THE HIGH COURT OF SINDH, KARACHI

Income Tax Reference Application No. 64 of 2012

Present: ***Mr. Justice Muhammad Junaid Ghaffar***
Mr. Justice Mohammad Abdur Rahman,

Applicant:	**Premier Mercantile Services (Pvt.) Ltd. Through Mr. Shams Mohiuddin Ansari, Advocate.**
Respondent:	**Commissioner Inland Revenue, LTU, Karachi through Mr. Muhammad Aqeel Qureshi, Advocate.**
Date of hearing:	**19.03.2025.**
Date of Judgment:	**28.04.2025.**

J U D G M E N T

Muhammad Junaid Ghaffar, Acting Chief Justice: Through this Reference Application, the Applicant has impugned Order dated 08.02.2012 passed in ITA No. 35/KB/2011 for tax year 2009 by the Appellate Tribunal Inland Revenue, at Karachi proposing various questions of law; however, vide order dated 30.10.2012, notice was only ordered on the following two questions of law:-

> 1) As to whether in the facts and circumstances of the case the provision of Section 85 of I.T. Ord. 2001 and interest u/s 39 of I.T. Ord. 2001 read with Section 108 of I.T. Ord. 2001 on the payment of Rs.15,000,000/- for the purchase of office made to Portlink International Services (Pvt.) Ltd. By the applicant / tax payer company is attracted?
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> 2) As to whether in the facts and circumstances of the case, on the salaries and wages amounting to Rs. 825,645/- paid to individuals falling below the prescribed threshold of Rs.15,000/- provision of Section 21(m) of I.T. Ord. 2001 is attracted?

2. Learned Counsel for the Applicant has contended that the forums below have erred in law and facts in passing the impugned order in respect of question No.1 inasmuch as the

amount in question was never an income so determined in terms of Section 108 of the Income Tax Ordinance, 2001 ("**Ordinance**") nor the amount of loan given to an associated company can be deemed to be an income without a deeming clause. He has further contended that no order was passed under the Ordinance to re-characterize the income already determined; and therefore, the impugned orders cannot be sustained. According to him the amount in question does not fall within the definition of receipt of income as provided under Section 69 of the Ordinance; hence, it cannot be taxed. In support he has relied upon certain judgments / orders[1].

3. On the other hand, Respondent's Counsel has supported the impugned order and submits that no case for any exception has been made out; and therefore, this Reference Application is liable to be dismissed.

4. Heard learned Counsel for the parties and perused the record. It appears that various issues were raised against the Applicant after audit of the income tax affairs under Section 177 of the Ordinance and insofar as the proposed questions are concerned, it was alleged as follows:-

> "7. **Issue of Advances at Rs. 1,579,056/- to staff and Rs. 15,000,000/- to M/S Portlink International services (Pvt) Ltd:**
> The tax payer was confronted as under:
>
> > *You have not charged interest on advance to staff at Rs:1,579,056/- and other person at Rs: 17,310,488/- (out of which Rs. 15.000(M) is given to M/s. Portlink International Services (Pvt) Ltd., one of your associated concern), which comes under the definition of associates under section 85 of the Income Tax Ordinance, 2001 and attracts*

[1] Commissioner of Income Tax, Companies-I, Karachi v. Messrs National Investment Trust Ltd. Karachi (2003 PTD 589), Commissioner of Income Tax, Peshawar Zone, Peshawar v. Messrs Siemen A.G (1991 PTD 488) and Judgment dated 04.09.2024 passed in ITRA No. 205 of 2023 (M/s. Elahee Buksh & Company (Pvt.) Ltd. V. the Additional Commissioner (Audit-III) Inland Revenue, Range-A-III, MTO Karachi and Two others) by this Court

the Provision of section-108. Accordingly bench mark interest rate (10%) is required to be charged and resultant interest income at Rs1,888,954.u/s 39, of the Income Tax Ordinance, 2001.

12. **Issue of Non-payment of expenses and salaries through banking channels- applicability of section 21(l) and 21(m) of ITO,2001.** The tax payer was confronted as under.

"Perusal of ledgers of Operating Cost, administrative Expenses vis a vis bank statement shows that you have not paid salaries/wages at Rs. 795,000/- and other payments at Rs. 825,645/- through banking channel as is enshrined in section 21(l) and 21(m) of ITO, 2001. Accordingly, the same has to be added in your income".

5. The Applicant responded to these objections and the issue regarding advances to staff amounting to **Rs. 1,579,056/-**; was decided in favour of the Applicant by accepting the plea so taken. However, in respect of loan to an associated company, the Assessing Officer passed an order; whereby, the amount of interest on the loan given was added to the income by invoking section 108 of the Ordinance and treating the same as a transaction liable to tax. As to the payment of expenses and salaries through non-banking channel, the Applicant furnished its reply and in fact admitted an amount of Rs. 825,645/- being payments other than wages and did not agitate the same; whereas the stance in respect of payment of salary to the extent of Rs. 795,000/- being within the prescribed limits in terms of Section 21(m) of the Ordinance was accepted. The Applicant filed an appeal before the Commissioner (Appeals) Inland Revenue, and to the extent of the two questions as above, the appeal was allowed. The Respondent department, being aggrieved, approached the Tribunal and the relevant finding of the Tribunal whereby the 1st Appellate order was set aside in favour of the Respondent / Department in respect of the proposed questions is as under: -

"7. GROUND NO. 4 & 5

The DR of the appellant/department argued that the learned CIR(A) has erred in deleting the addition on account of interest free advances to associated companies of the taxpayer. He submitted that the taxpayer has given Rs. 15.000(M) to his concerned associate company M/s. Portlink International Services (Pvt) Ltd which comes under the definition of Associates under Section 85 of the Income Tax Ordinance, 2001 and attracts the Provision of Section 108, therefore, the interest rate 10% is required to be charged under Section 39, of the Income Tax Ordinance, 2001. He further submitted that the taxpayer has also paid Rs. 16,723,111/- to M/s. Izhar Constructions (Pvt) Ltd, for construction of a pre-engineered building comprising of erection of steel building. The amount claimed under repair and maintenance of office is not sustainable in the eyes of law and can not be allowed as it is a capital expenditure, therefore, taxpayer is liable to pay additional amount under Section 21(n) of the Income Tax Ordinance, 2001.

On the other hand, the learned representative of the taxpayer has supported the decision of the Learned CIR (A). The learned AR argued that the DCIR while making addition on this score has completely ignored the factual position of the case which resulted in misapplication of provisions of section 108 of the Ordinance, which is unwarranted in law. He submitted that the taxpayer has advanced the amount of Rs. 15.000(M) to M/s. Portlink International Services (Pvt.) Ltd, for the purchase of office at Lahore, which was not finalized during the tax year under appeal, hence DCIR has misdirected himself in not appreciating the above factual position and wrongly invoked the provisions of Section 108 of the Ordinance, which comes into play only in respect of those transactions where the main purposes of a person in entering into the transaction is the avoidance or reduction of any person's liability to tax under this ordinance, therefore, the addition made by the DCIR on this score be deleted.

We have considered the arguments of learned representatives of both the sides and have also perused the record. We find that the claim of the taxpayer regarding advances to his co-owned companies is not legally sustainable as it comes under the ambit of associates under Section 85 of Income Tax Ordinance, 2001, which CIR(A) has not examined carefully. The DCIR has decided the case after taking into account the deliberation and in accordance with law. We are of the considered opinion that the DCIR has been given reasonable opportunities to the Taxpayer and had made addition after confronting through Section 108 of the Income Tax Ordinance, 2001 is within the jurisdiction hence the order passed by the DCIR is restored.

8. **GROUND NO. 6**

The learned DR of the appellant argued that as per ledgers of operating cost administrative expenses vis a vis bank statement the taxpayer has not paid salaries/wages at Rs. 795,000/- and other payment at Rs. 825,645/- through banking channel as is enshrined in Section 21(1) and 21(m) of the Income Tax Ordinance, 2001, therefore, the taxpayer is liable to pay the additional amount as per the above section but the learned CIR(A) has not appreciated the same and erred in deleting the addition under Section 21(m) on account of non-payment of wages through banking channels, which is illegal, unlawful and without jurisdiction hence to be vacated.

On the other hand, the learned representative of the taxpayer has supported the decision of the Learned CIR (A). The learned AR argued that the

addition made by the DCIR is based on misapplication of provision of Section 21(m) of the Ordinance. He submitted that Rs. 825, 645/- represent payment of wages to different workers hired by the taxpayer on daily wages, in respect of the said payment complete details was submitted before DCIR, but the DCIR malafidely did not consider the same. He further submitted that individual cash payment of wages being below the prescribed threshold Rs. 15,000/- as envisaged under Section 21(m) of the Ordinance, there was no occasion with the DCIR to make any disallowance on this score, hence the additions made by the DCIR in this regard is arbitrary, malafide, colorable exercise of jurisdiction, hence liable to be deleted.

Keeping in view the submissions of the learned representatives we are persuaded to agree with the learned Counsel for the Department that provision of section 21(1) and 21(m) has been inserted on purpose by the legislature. The legislature was mindful of the lacuna or shortcoming that persisted in the repealed Ordinance with regard to inability of the functionaries of the Department to assess and recover advance tax from those who have been made liable by the word of law but would deprive the exchequer the legitimate revenue for a whole year or so by taking advantage of the lacuna available in the law. Not only this, but there are certain other unprecedented measures which have been taken by the legislature in the Income Tax Ordinance, 2001 to make the voluntary compliance more effective. In view of foregoing it is held that the learned AR of the taxpayer has not been able to advance plausible, satisfactory and cogent arguments to press home his contention. We have no hesitation in holding that the DCIR not only can pass an order under section 21(1) and 21(m) of the Income Tax Ordinance, 2001 to make addition in the income of the taxpayer in terms of section 21(1) who fails to pay the same on his own in accordance with the provisions of the Ordinance but can also proceed to recover the same like any other tax demand due in pursuance of an order under the Ordinance and all the provisions of the Ordinance relating to assessment and recovery shall apply accordingly.

After carefully examining the case records it transpires that the CIR (A) has ignored the relevant provision of law and passed the impugned order considering the relevant documents. Therefore, the order by the CIR(A) in this ground is vacated."

6. Insofar as the case as setup on behalf of the Applicant regarding Section 69 of the Ordinance is concerned, the same does not appear to have any relevance with the issue in hand as apparently the Applicant was confronted that M/s Portlink International Services (Pvt) Ltd. is one of the associated concern to whom an advance of Rs. 15.000 million was given; whereas, the said associated concern comes within the definition of Section 85 of the Ordinance; hence transaction attracts Section 108, which reads as under: -

"108. Transaction between associates—(1) The Commissioner may, in respect of any transaction between persons who are *associates, distribute, apportion or allocate income, deductions or tax credits between the persons as is necessary to reflect the income that the persons would have realized in an arm's length transaction.*

(2) In making any adjustment under sub-section (I), the Commissioner may determine the source of income and the nature of any payment or loss as revenue, capital or otherwise.

(3) Every taxpayer who has entered into a transaction with its associate shall:

(a) mainland a master file and a local file containing documents and information as may be prescribed;

(b) keep [, maintain and furnish to the Board] prescribed country-by-country report, where applicable;

(c) keep and maintain any other information and document in respect of transaction with its associate as may be prescribed; and

(d) keep the files, documents, information and reports specified in clauses (a) to (c) for the period as may be prescribed;

(4) A taxpayer who has entered into a transaction with its associates shall furnish, within thirty days the documents and information to be kept and maintained under [clause (a), (c) or (d) of] sub-section (3) if required by the Commissioner in the course of any proceedings under this Ordinance;

(5) The Commissioner may, by an order in writing, grant the taxpayer an extension of time for furnishing the documents and information under sub-section (4), if the taxpayer applies in writing to the Commissioner for an extension of time to furnish the said documents or information;

Provided that the Commissioner shall not grant an extension of more than forty-five days, when such information or documents were required to be furnished under sub-section (4), unless there are exceptional circumstances justifying a longer extension of time.

(6) Notwithstanding the provisions of sub-section (1), for the tax year 2024 and onwards, were any amount is claimed as deduction for the tax year or for any of the two proceeding tax years on account of royalty paid or payable to an associate directly or indirectly in respect of use of any brand name, logo, patent, invention, design or model, secret formula or process, copyright, trademark, scientific or technical knowledge, franchise, license, intellectual property or other like property or right or contractual right and on a notice issued by the Commissioner, the taxpayer fails to furnish any explanation or evidence that no benefit has been conferred on the associate, twenty five percent of the total expenditure for the tax year in respective sales promotion, advertisement and publicity shall be disallowed and allocated to the said associate.]"

7. The aforesaid Section empowers the Commissioner in respect of any transaction between associated concerns to distribute, apportion or allocate income, deductions or tax credits between such persons as is necessary to reflect the

income that the persons would have realised in an "***arm's length transaction"***. Here admittedly the relationship between the Applicant and the Associated concern has not been denied; nor it is denied that the amount in question was not advanced as a loan. Though, before this Court an attempt has been made to state that the amount in question was given by way of Investment Agreement; however, this Agreement was never relied upon before the forums below; hence, we in this Reference Application cannot dilate upon it. In terms of Rule 23 of the Income Tax Rules, 2002, the Arm's length Standard is that while determining the income of a person from a transaction with an associate, the standard to be applied by the Commissioner shall be that of a person dealing at arm's length with a person who is *not an associate*. Therefore, if the amount in question would have been loaned to a non-associate, it would have resulted in interest income and that is what section 108 permits. Such income was supposed to be taxable otherwise; however, by entering in such a transaction with an associate, tax on such income has escaped. An argument can also be advanced that since both companies in question are associated concerns, the net effect of the action of the department would not have any overall implication on the income as a Group; however, this may not be a correct approach. The total income (or loss) as well as the rate of tax so applicable on both concerns may differ; hence, this argument in and of itself cannot come to the rescue of a taxpayer. Section 108 of the Ordinance keeps a check on tax avoidance and if a transaction is not found to be falling within such limitation, then it will attract levy of tax as not being at arm's length. The transaction in hand is on non-arm's length standard; hence, taxable. The Applicants response as is available on record was that it was extended against the

purchase of co-owned assets (offices) at Lahore, and in support, a certificate was produced from Port Link International Services (Pvt) Limited along with copy of letter from Director, Lahore Development Authority, showing that Plot No.229, Block A/3. Gulberg, Lahore in its name. In view of such stance of the Applicant before the department, now it cannot be argued that the amount was an investment in property's purchase as the property is not in the name of the Applicant even as an owner. Such onus has not been discharged on production of an agreement between associated companies. Even otherwise the Applicant has not shown any addition of an asset in its wealth statement bought with this advanced amount. Therefore, if the said amount would have not been advanced as a loan, then the Applicant would have earned interest on such amount and the assessing officer, has therefore, confronted the Applicant as to why the said amount of interest be not added as an income of the Applicant being a non-arm's length transaction. In the given facts and circumstances, it is neither a case of any re-characterized or unexplained income; or for that matter, any other income as contended on behalf of the Applicant. In terms of sub-section (2) of Section 108 while making any adjustment under subsection (1), the Commissioner can determine the source of income and nature of payment, or loss as revenue, capital or otherwise. This is what exactly has been done by the officer concerned. The other argument of the Applicant's Counsel to the effect that at best a notice ought to have been issued to the Associated concern and not to the Applicant, it would suffice to observe that Section 108 of the Ordinance does not put any such restriction as it empowers the Commissioner to adjust such income in the manner it has been done.

8. Notwithstanding this, in fact if the Associated concern had borrowed such money, then the said Associated concern would have paid interest, which could be claimed as an expense, and therefore, this argument does not hold field. As already noted, advanced amount as a loan never resulted in any ownership of the property in the name of the Applicant, which was purchased by the associated concern in its own name; hence, it cannot even be called a capital expense. In view of such position, the Tribunal was justified in setting aside the finding of the Commissioner (Appeals) in respect of proposed question No.1, and therefore, no case for any interference is made out.

9. Insofar as question No. 2 is concerned, it reflects that the finding of the Assessing Officer as available on record and on facts which cannot be disputed is that the Applicant was confronted with two amounts i.e. salaries and wages of *Rs. 795,000/-* and other payments of *Rs. 825,645/-* which had been paid without proper banking channel; therefore, it was alleged that the provisions of Section 21(l) and 21(m) of the Ordinance are attracted and such amounts are liable to be added in the income. The Applicant responded that insofar as the amount of salary and wages of *Rs. 795,000/-* is concerned that was within the prescribed limits of Rs. 15,000/- as provided in Section 21(m) (ibid) and such stance of the Applicant was accepted. As to the other payment, as per available record, the applicant had never agitated it with any plausible defence. At the same time, the Respondent department had not impugned the finding of the Assessing Officer in respect of payment of salaries and wages of *Rs. 795,000/-* before the Commissioner (Appeals); however, impugned order reflects that that a finding has been recorded by the Tribunal in respect of both the amounts, which the Tribunal could not have done as the issue in respect of

payment of salaries and wages of *Rs. 795,000/-* decided in favour of the Applicant by the assessing officer was never challenged by the Department. Therefore, the order of the Tribunal is set-aside to this extent. In respect of the other amount / payment of Rs. 825, 645/-, it is hereby held that since the Applicant had failed to agitate this issue, therefore, it was correctly added to the income of the Applicant in terms of Section 21(m) of the Ordinance.

10. In view of hereinabove facts and circumstances of this case, the proposed questions as recorded in Order dated 30.10.2012 are answered against the Applicant and in favour of the Respondent and as consequence thereof, this Reference Application is ***dismissed***; however, with the above modification. Let copy of this order be issued to the Appellate Tribunal, Inland Revenue, Karachi in terms of section 133(5) of the Income Tax Ordinance, 2001.

Dated: 28.04.2025

ACTING CHIEF JUSTICE

J U D G E

Ayaz