

IN THE HIGH COURT OF SINDH AT KARACHI

Present:

Mr. Justice Agha Faisal

Mr. Justice Dr. Shah Nawaz Memon

Income Tax Reference Application No. 365 of 2022

ThalNova Power Thar (Private) Limited, Karachi VS Commissioner of Inland Revenue
CTO, Karachi

Dates of hearing: 28.09.2026

Date of decision: 01.10.2026

Applicant: Through M/s. Hamza Waheed and Sami-ur-Rehman Advocates.

Respondent: Through Barrister S. Ahsan Ali Shah Advocate

J U D G M E N T

DR. SHAH NAWAZ MEMON, J.: — This reference application under section 133 of the Income Tax Ordinance, 2001 (“the Ordinance”) raises a question which has come before this Court with some frequency: whether default surcharge under section 205 of the Ordinance follows automatically upon the fact that tax was deducted or paid late, and if it does not, what the officer must find before levying it and upon whom the burden lies. The learned Appellate Tribunal Inland Revenue held that “in the case of charging of default surcharge the rule of *mens rea* is not applicable”. The applicant contends that the department must establish *mens rea*.

I. FACTS OF THE CASE

2. The applicant is a private limited company engaged in the generation of electric power. On 13.06.2019 and 19.06.2019 it paid Rs. 4,641,227,500/- to China Machinery Engineering Corporation, a non-resident, as an advance to its EPC contractor. Tax was not deducted at the time of payment. The applicant deposited the tax attributable to that payment, in terms of section 152(1A)(a) of the Ordinance, on 15.06.2020.
3. In monitoring proceedings for tax year 2019, the Deputy Commissioner Inland Revenue, Audit-III, Unit-11, Range-D, Corporate Tax Office, Karachi issued a show cause notice dated 15.02.2021 under section 161(1A) read with section 205. The applicant’s reconciliation was accepted on every head confronted. As to the payment to the non-resident, the officer held that since the payment was made in June 2019 and the tax was paid in June 2020, “it therefore constituted a delay in payment of tax which is liable to Default Surcharge under the provisions of

section 205”, and by order dated 31.03.2021 levied default surcharge of Rs. 11,946,860/-. No principal tax was found outstanding.

4. The applicant’s appeal was dismissed by the learned Commissioner Inland Revenue (Appeals-VII), Karachi by order dated 01.04.2022. Relying upon *Bilq*,¹ the learned Commissioner observed that default surcharge “is an interest which is paid by the taxpayer for using government money”, and that since the applicant is assisted by chartered accountants and tax advisors “it cannot be assumed that they were not advised of the correct interpretation of law”. The further appeal, ITA No. 694/KB/2022, was dismissed by the learned Appellate Tribunal Inland Revenue by order dated 31.08.2022. The learned Tribunal held that default surcharge was being confused with penalty, “for which establishing of *mens rea* is required”, and that “in the case of charging of default surcharge the rule of *mens rea* is not applicable”.

II. THE QUESTION PROPOSED

5. The applicant has proposed the following question:

“Whether the learned ATIR was justified to uphold the levy and imposition of default surcharge on the Applicant?”

6. So stated, the question is wide enough to invite a rehearing of the facts, which is not the office of this jurisdiction. The controversy argued at the bar was narrower, and we reframe the question as under, so that the real controversy between the parties may be settled:²

“Whether default surcharge under section 205 of the Income Tax Ordinance, 2001 follows automatically upon a failure to deduct or pay tax by the due date; and if not, what must be established before it is levied, and by whom?”

III. SUBMISSIONS

7. Mr. Hamza Waheed, learned counsel for the applicant, submitted that the matter is covered by the judgment of a Division Bench of this Court in *China Power Hub*,³ which was maintained by the Hon’ble Supreme Court of Pakistan in C.P.L.A. No. 546-K of 2021 by order dated 10.02.2022. He submitted that it is mandatory for the department to establish *mens rea* before default surcharge can be imposed under section 205, and relied also upon *D.G. Khan Cement*,⁴ *ICI Pakistan*,⁵ and *Tianshi*.⁶ His further submission was that when the Legislature wished to dispense with *mens rea* it said so. By the Finance Act, 2021 it added an Explanation to

¹*Bilq (Pvt.) Ltd. v. DCIT* [2002 PTD 1].

²*Squibb Pakistan v. CIT* [2017 SCMR 1006], paras 19, 49 and 50: the High Court may reformulate the questions referred, the reference under section 133 being appellate in nature and extending to any question of law arising out of the order of the Tribunal.

³*China Power Hub Generation Co. v. Pakistan* [2024 PTD 1218].

⁴*D.G. Khan Cement Co. v. Federation of Pakistan* [2004 PTD 1179 = 2004 SCMR 456].

⁵*Deputy Collector, Central Excise and Sales Tax v. ICI Pakistan Ltd.* [2006 SCMR 626].

⁶*CIR v. Tianshi International Pakistan Co.* [2018 PTD 900].

section 182 declaring that establishing *mens rea* is not necessary for levying a penalty under that section, but it added nothing to section 205. The law as it stood, he submitted, therefore continues to govern default surcharge.

8. Barrister S. Ahsan Ali Shah, learned counsel for the respondent, submitted that liability to default surcharge under the Ordinance is strict. It arises upon the failure to deposit public money by the due date, and no separate proof of a guilty mind is required of the department. He relied upon *MCB Bank*,⁷ *Chawla Footwear*,⁸ an unreported order of a Division Bench of this Court dated 21.05.2026 in I.T.R.A. Nos. 411 to 413 of 2025, and *Bank of Punjab*.⁹
9. We have heard learned counsel and considered the record, the authorities cited at the bar and such further authority as our own research has yielded.

IV. SECTION 205: THE LEVY IS NOT AUTOMATIC

10. The limb of section 205 which applies to a withholding agent is sub-section (3):

“(3) A person who fails to collect tax, as required under Division II of Part V of this Chapter or Chapter XII or deduct tax as required under Division III of Part V of this Chapter or Chapter XII or fails to pay an amount of tax collected or deducted as required under section 160 on or before the due date for payment shall be liable for default surcharge at a rate equal to 12 per cent per annum on the amount unpaid computed for the period commencing on the date the amount was required to be collected or deducted and ending on the date on which it was paid to the Commissioner: ...”

11. The operative words are “shall be liable for default surcharge”. Sub-section (1) is framed in the same way, and sub-section (5) requires the Commissioner to make an assessment of default surcharge “as if the default surcharge were tax”. The section does not say that the defaulter “shall pay” the surcharge, and it says nothing, one way or the other, about the state of mind with which the default was committed.
12. The words “shall be liable” have received authoritative construction. In *ICI Pakistan* the Hon’ble Supreme Court was concerned with section 34 of the Sales Tax Act, 1990 as it then stood, under which a registered person who failed to pay tax in time “shall ... be liable to pay additional tax and surcharge”. Their Lordships held that “[t]he liability being not automatic would be determined by the appropriate authority as to whether or not there was any reasonable ground for default in payment of sales tax which could be considered to be wilful and deliberate”. That conclusion rested on the settled understanding that such an expression calls for an application of mind by the authority and not a

⁷*CIR v. MCB Bank Ltd.* [2021 SCMR 1325].

⁸*Chawla Footwear v. CIR* [2025 PTD 574].

⁹*CIT v. Bank of Punjab* [2020 PTD 1].

consequence which follows of itself,¹⁰ and on the principle stated in *D.G. Khan Cement* that each case is to be decided on its own merits. The expression in section 205 is the same.

13. This Court has read section 205 accordingly. In *Tianshi* a Division Bench held that section 34 of the Sales Tax Act, 1990 was not materially different in scope from sections 161 and 205 of the Ordinance so far as “default” and “wilful default” are concerned. In *China Power Hub* a Division Bench held that default surcharge “is not to be imposed in a mechanical manner; but only after a proper adjudication as to the willful default and presence of *mens-rea*”, and that the adjudication is to be made by the officer together with the order under section 161, upon a combined notice. A Division Bench of this Court is bound by the view of a coordinate Bench,¹¹ and we see no reason to differ from it.
14. Nor has the Legislature displaced that view. When it intended surcharge to follow regardless of the defaulter’s state of mind, it said so: by the Finance Act, 2005 section 34 of the Sales Tax Act, 1990 was recast to apply to a default “whether willfully or otherwise”, and it was upon those words that the Hon’ble Supreme Court held in *Byco Petroleum* that section 34 is a strict liability provision attracted “whether it be deliberate or unintentional or inadvertent”.¹² Those words are not found in section 205. Again, by the Finance Act, 2021 the Legislature added an Explanation to section 182(2) declaring that “establishing *mens rea* is not necessary for levying of penalty under this section”. The Explanation is confined in terms to penalty. Section 205 has itself been amended by the Finance Acts of 2012, 2015, 2017, 2020 and 2024, yet nothing has been added to it touching the defaulter’s state of mind. The intention of the Legislature is to be gathered from the words it has used,¹³ and what it has chosen to say in section 34 of the Sales Tax Act and in section 182 of the Ordinance, but not in section 205, cannot be supplied by construction. To this extent the submission of learned counsel for the applicant is well founded, and the premise upon which the learned Tribunal proceeded cannot be sustained.

V. WHAT MUST BE ESTABLISHED, AND BY WHOM

15. That the levy is not automatic does not lead to the further proposition urged on behalf of the applicant, namely that the department must prove, by evidence of its own, the state of mind of the withholding agent. Nor does it mean that the department may levy the surcharge upon a bare allegation. The real question is

¹⁰*Shamroz Khan v. Muhammad Amin* [PLD 1978 SC 89]; *Muhammad Musa v. Settlement and Rehabilitation Commissioner* [1974 SCMR 352], both relied upon in *ICI Pakistan*.

¹¹*Multiline Associates v. Ardesbir Cowasjee* [PLD 1995 SC 423].

¹²*CIR v. Byco Petroleum Pakistan Ltd.*, order dated 05.07.2024 in C.P. Nos. 1221-K to 1257-K and 1290-K to 1299-K of 2022 (not approved for reporting). The order also records, in para 3, that the language of section 205 is “more or less *pari materia* to the erstwhile Section 34”.

¹³*IESCO v. Appellate Tribunal Inland Revenue* [2023 SCMR 1516].

what each side must establish. On that question the Hon'ble Supreme Court has laid down the governing principles in *MCB Bank*, *Chawla Footwear* and *Bilz*, which must be read together with the scheme of the Income Tax Rules, 2002.

16. *MCB Bank* identifies the event which sets the machinery in motion. Their Lordships held, with reference to section 161, that “the section becomes applicable not simply because a payment is made (or a transaction or event happens) but rather on a failure to either collect tax or deduct it. It is the failure that is the triggering event.” They then fixed the threshold which the department must cross before it can put a person to proof: “There must, at least initially, be some reason or information available with the Commissioner for him to conclude that there was, or could have been, a failure to deduct. That reason or information must satisfy the test of objectiveness ... It is only if this threshold is successfully crossed that the notice can be issued, and it is only then that the burden may shift on the person allegedly in default to show that section 161 does not, or ought not to, apply.”
17. *MCB Bank* also shows how the threshold is applied to a notice. The notices for tax years 2003 to 2006 gave a single consolidated figure against each head of expenditure for the whole year, and ended with a general paragraph that “any other payment made during the year ... may also be included”. Those notices were held to be “nothing but a blatant fishing expedition”. The notice for tax year 2011 contained, besides the annual figures, a breakup of the deductions required under each relevant section, the deductions actually made and the shortfall, and it contained no rounding off paragraph. That notice survived, because “there was an application of mind to the question whether there had been a failure to deduct and if so, on what basis and in what amount”. In *IESCO*, where the officer had cross matched the audited accounts with the withholding statements and the returns and called for documentary evidence of the payments, the Hon'ble Supreme Court distinguished *MCB Bank* and upheld the proceedings.
18. *Chawla Footwear* carries the matter one step further. Their Lordships noticed that the statements which a withholding agent is required to file are designed to record, against each payment, the tax deducted and “the justifications for any instances where tax was not deducted”, so that “it is compulsory to document the reasons for any non-deduction of tax”. They held: “Consequently, if a taxpayer fails to collect or deduct tax from payments made during the tax year, such inaction is deemed as a default under section 161. Therefore, the point that sets the machinery of section 161 going to determine the tax liability is the failure to either collect tax or deduct it.” Reaffirming the objective threshold in *MCB Bank*, they added that “upon successfully crossing this threshold, the notice under

section 161 can be issued, and it is only then that the taxpayer can be brought under a burden to show that it is not in default”. Applying that test, their Lordships upheld a notice which identified the persons from whom purchases were made, compared the purchases declared with those verified, broke down the purchases subject to tax and specified the categories under which tax was applicable. The reconciliation which the Commissioner may require under rule 44(4) of the Rules, of the amounts in the withholding statements with those in the return and the accounts, is the statutory means by which such a failure is brought to the surface.

19. *Bilz*, upon which the learned Commissioner (Appeals) relied, is to the same effect, although *MCB Bank* has confined it to its own facts. There the notice set out the payments, the rate and the fact that nothing had been withheld; “no reason in this behalf has been offered by the petitioner”, and despite sufficient opportunities no details were furnished for not deducting the tax. The assessee was held to be in default under section 52, and the additional tax under section 86 of the repealed Ordinance, the predecessor of section 205, was sustained with it.
20. Read together, these decisions settle the burden. The reasons why tax was not deducted, or was deposited late, are facts peculiarly within the knowledge of the withholding agent; the Rules require him to record them; and Article 122 of the Qanun-e-Shahadat Order, 1984 places the burden of proving such a fact upon the person within whose knowledge it lies. Section 161 and section 205 are, moreover, adjudicated together, upon one notice and in one order. It would be incongruous if, upon the same default, the withholding agent bore the burden of explaining the non-deduction for the purposes of section 161 while the department bore the burden of disproving that very explanation for the purposes of section 205. The formulation in *ICI Pakistan*, which asks “whether or not there was any reasonable ground for default”, itself directs the enquiry to the explanation offered by the defaulter.
21. We would therefore state the position thus. At the first stage the burden is on the department. It must have reason or information satisfying the objective test in *MCB Bank* and *Chawla Footwear*; it must issue a notice under section 161 read with section 205 which shows an application of mind to whether there was a failure, on what basis and in what amount, and which is not a roving enquiry; and it must establish the failure, that is, the non-collection or non-deduction, or the non-payment by the due date, upon the material before the officer, which may include the withholding agent’s own statements and reconciliation. At the second stage, once the failure is established, the burden passes to the withholding agent, and it may be discharged in either of two ways. The withholding agent may show that it

was not in default at all, because the payment was outside the obligation to deduct, or was covered by an exemption, or the tax was in fact deducted and paid; that answers both the tax and the surcharge. Or, where the default stands, it may show that the default was not wilful, in the sense that there was a reasonable ground for it; that answers the surcharge alone. A *bona fide* reliance upon an exemption certificate, a genuine question as to whether the payment attracted deduction at the time it was made, or a prompt and voluntary rectification before any proceedings were taken, are the kind of circumstances which may be considered, each case turning on its own facts. At the third stage the officer must consider the explanation offered and record a finding upon it. Where no reason is offered despite opportunity, as in *Bilz*, or the reason offered is rejected for reasons recorded, the surcharge follows. What section 205 does not permit is a levy upon the bare fact of delay without the explanation offered having been considered.

22. So understood, the position neither makes the levy automatic, contrary to *ICI Pakistan*, *Tianshi* and *China Power Hub*, nor requires the department to prove a guilty mind, contrary to the principle in *Chawla Footwear*. The unreported order relied upon by learned counsel for the respondent applies *Chawla Footwear* in the same manner, holding that once payments without deduction are shown the burden shifts to the withholding agent, and sustaining the tax together with the surcharge where no satisfactory explanation was furnished. *Bank of Punjab* concerned the basis on which interest on Government securities is taxed, and does not bear upon the present question.

VI. THE SHOW CAUSE NOTICE IN THIS CASE

23. We turn to the first stage. The show cause notice dated 15.02.2021 was issued under section 161(1A) read with section 205. It recited that the applicant's reply to the notice under rule 44(4) had been examined and that examination of the audited accounts revealed payments attracting withholding provisions on which tax appeared not to have been deducted. It then set out, head by head from note 13 of the accounts, the amount of each expense, the applicable rate and the tax required to be deducted. It identified, from notes 3.1 and 3.2, the additions to operating assets of Rs. 56,269,132/- and to capital work in progress of Rs. 5,033,346,132/-, and required the applicant to reconcile them under rule 44 with party wise ledgers, proof of payment and withholding challans, and to state the instances of short or no deduction. It contained no rounding off paragraph of the kind condemned in *MCB Bank*. The notice drew upon the audited accounts and the withholding record, specified the heads and amounts in issue, and called for a reconciliation of a defined kind. It is of the character of the notice upheld in *MCB*

Bank for tax year 2011 and of those upheld in *IESCO* and *Chawla Footwear*, and not of a fishing expedition.

24. The particular payment was disclosed in Annex-01 to the applicant's reply, and the order-in-original records it as a payment to a non-resident liable to tax under section 152. At the hearing on 24.03.2021 the applicant was confronted with its own CPR dated 15.06.2020 showing deposit of the tax a year after the payment. The learned Commissioner (Appeals) found, and it has not been shown otherwise, that the applicant was confronted with the levy of default surcharge. The objection taken in reply that the notice did not name the provision under which tax was deductible does not affect its validity, the allegation being clear and the applicant having answered it.¹⁴ The first stage is therefore satisfied. The failure is established, and the burden passed to the applicant.

VII. THE EXPLANATION OFFERED, AND HOW IT WAS DEALT WITH

25. The burden having passed to the applicant, the next question is whether it offered an explanation for the default and how that explanation was dealt with. Much of the case advanced on its behalf, before the forums below and before us, was the legal submission that the department had to prove *mens rea*. That submission fails for the reasons already given, and it is not itself an explanation. But the record shows that it was not the whole of the applicant's case.
26. Before the officer, the reply to the show cause notice took the objection that the notice did not name the provision under which tax was deductible, and explained in general terms that differences arise between expenses booked on the accrual basis and withholding on the payment basis, and that certain payments do not attract deduction by reason of exemptions, certificates or thresholds. The payment in question was disclosed in Annex-01 to the reply. The order-in-original records no specific reason for the delay beyond this.
27. Before the learned Commissioner (Appeals) the applicant set out its explanation in detail, and it is recorded in his order. In substance it was this. First, the payments were the first mobilisation advance under an offshore supply contract with China Machinery Engineering Corporation for the coal fired power plant at Thar, made in two instalments in June 2019 on completion of milestones, the equipment being imported in the applicant's name and tax being discharged at the import stage under section 148. Secondly, the payments were made without deduction in reliance on Article 7 of the Pakistan-China tax treaty read with section 107, the contractor having no permanent establishment in Pakistan, and on section 152(7) as it then stood, which excluded payments for imports where

¹⁴*Attock Refinery Ltd. v. Collector of Sales Tax* [2021 PTD 1680].

title passes outside Pakistan; under article 16.1.2 of the contract title to the equipment passed outside Pakistan. Thirdly, after section 152(4B) was inserted by the Finance Act, 2019, the applicant applied on 28.10.2019 for deduction at a reduced rate; the Commissioner rejected the application on 30.12.2019; on revision under section 122B(1) the Chief Commissioner remanded it on 22.01.2020; and by order dated 04.06.2020 the Commissioner allowed deduction at thirty per cent of the applicable rate. Fourthly, the tax so determined was deposited on 15.06.2020, eleven days after that order, and the applicant contended that the surcharge was wrongly levied for that reason.

28. That explanation was not adjudicated. The order-in-original, which preceded it in this form, levied the surcharge upon the fact of delay alone. The learned Commissioner (Appeals) framed the issue as one of delay, and his findings deal with whether the applicant was confronted, with *Bilz*, with the premise that a taxpayer served by professional advisors must be taken to have been correctly advised, with the character of surcharge as interest for the use of Government money, and with the calculation. The treaty position, the passing of title outside Pakistan, the application under section 152(4B) and the Commissioner's order of 04.06.2020 are not discussed. Before the learned Tribunal the explanation was carried in grounds 6 and 8 of the memorandum of appeal; the learned Tribunal, having held that the rule of *mens rea* is not applicable to default surcharge, did not take it up.
29. Whether that explanation shows that the applicant was not in default at all, or that there was a reasonable ground for the default for the whole or any part of the period for which surcharge has been levied, depends upon matters of fact: whether the treaty position and the reading of section 152(7) were *bona fide* tenable when the payments were made, whether the reduced rate route was pursued with diligence, and what bearing the Commissioner's order of 04.06.2020 has upon the period of default. It will be equally open to the department to contend that the applicant, having ultimately accepted liability, cannot rely upon those positions as a reasonable ground and/or *Ignorantia legis neminem excusat*. These are questions upon which the learned Tribunal is the final forum. It is not for this Court to determine them in reference jurisdiction, and we express no view upon them.

VIII. THE ANSWER TO THE QUESTION

30. The question framed in paragraph 6 above is answered in the following terms. Default surcharge under section 205 of the Income Tax Ordinance, 2001 is not attracted automatically upon a failure to collect, deduct or pay tax by the due date. The department must establish the failure, upon a notice under section 161 read with section 205 which meets the threshold laid down in *MCB Bank* and *Chawla*

Footwear. Once the failure is established, the burden lies upon the withholding agent to show either that it was not in default or that there was a reasonable ground for the default. The officer must consider the explanation offered and record a finding upon it; where no reason is offered despite opportunity, or the reason offered is rejected for reasons recorded, the surcharge follows.

31. The learned Tribunal was accordingly not justified in upholding the levy of default surcharge upon the footing that the rule of *mens rea* is not applicable to default surcharge. In terms of section 133(7) of the Ordinance its order dated 31.08.2022 stands set aside, and ITA No. 694/KB/2022 shall be treated as pending before the learned Tribunal for the limited purpose of determining, after hearing both sides and upon the material on record, whether the explanation offered by the applicant, as set out in paragraph 27 above, shows that it was not in default or that there was a reasonable ground for the default for the whole or any part of the period, and of passing an order on the levy of default surcharge in the light of this judgment.
32. Nothing in this judgment touches the construction of section 182 of the Ordinance or the liability for principal tax under section 161, neither of which arises.

IX. ORDER

33. The reference application is disposed of in the above terms, with no order as to costs.
34. Let a copy of this judgment be sent under the seal of this Court and the signature of the Registrar to the learned Appellate Tribunal Inland Revenue in terms of section 133(8) of the Ordinance.

J U D G E

J U D G E

Karachi,

Dated: 1st day of October 2026

Ayaz PS.