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Judgment Sheet

IN THE LAHORE HIGH COURT LAHORE
JUDICIAL DEPARTMENT

Case No: **W.P. 14832/2014**

Sui Northern Gas Pipelines	**Versus**	Deputy Commissioner Inland Revenue, etc.

JUDGMENT

Dates of hearing	23.06.2014, 24.06.2014
Petitioner by:-	Mr. Mansoor Usman Awan, Advocate in W.P. No.14832/2014. Mr. Muhammad Raheel Kamran Sheikh, Advocate in W.P. No.16046/2014.
Respondents by:-	Mr. Muhammad Ilyas Khan, Advocate. Shahid Hussain Asad, Member Inland Revenue Policy, Federal Board of Revenue. Mustafa Ashraf, Chief Commissioner, LTU, Lahore. Imran Raza Kazmi, Commissioner Inland Revenue, LTU, Lahore. Neelam Ifzal, Deputy Commissioner Inland Revenue, LTU, Lahore.

Syed Mansoor Ali Shah, J:-

Facts

Petitioner i.e., Sui Northern Gas Pipeline Limited **(“SNGPL”)**, is a public limited company engaged in the business of operation and maintenance of high-pressure gas transmission, distribution network and sale thereof. It regularly purchases gas from Permanent Establishment of Non-resident Petroleum Exploration and Production Companies (“E&P”). SNGPL has been served with Show Cause Notice dated 19.5.2014 under section 161(1A) of the Income Tax Ordinance, 2001 (“***Ordinance***”) for non-deduction of tax from the

payments made to the E&Ps for Tax Years[1] 2013 and 2014 under section 152(2A) of the Ordinance. During the pendency of these petitions, Assessment Orders for all the above years were also passed on 09.06.2014 by the concerned Deputy Commissioner Inland Revenue (Respondent no.1) and have been placed on the record by the Respondents.

2. Subsequently, one of the E&Ps (i.e., PKP Exploration Ltd) also challenged[2] the above Show Cause Notice served on SNGPL, because as a consequence, SNGPL under section 161(2) demanded the amount of the aforementioned deduction from the petitioner E&P.

3. Learned counsel for the petitioners in both the petitions argued that as the taxpayer (E&P) has paid the tax for the quarter through Advance Tax, therefore, the lapse on the part of SNGPL to deduct tax under section 152(2A) is inconsequential as the tax has been duly paid for the quarter. They submitted that SNGPL can best be visited with a *default surcharge* under section 161(1B) but cannot be held liable to pay the deductible amount of tax under section 152(2A). Learned Counsel for E&P submitted that the taxpayer has neither availed any tax credit under section 147(4) nor has adjusted or deducted any amount from the quarterly payment of advance tax, hence the amount of tax in question is the tax paid in terms of section 161(1B) and the deductible amount of tax cannot be recovered from SNGPL or the taxpayer. Reliance was placed on *Commissioner of Income Tax, Zone-C, Lahore v. Messrs Margalla Textile Mills Ltd., Lahore* (**2008 PTD 1982**), *Karachi Port Trust, Karachi v. Commissioner Inland Revenue, Karachi*

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[1] *Special Tax Year* under section 74 of the Ordinance i.e., 1st January to 31 December.
[2] W.P. 16046/2014

(**2011 PTD 1996**), *Chairman, Central Board of Revenue, Islamabad and 3 others v. Messrs Pak-Saudi Fertilizer Ltd.* **(2000 PTD 3748)** and *Messrs Riaz Bottlers Pvt. Ltd. through Tax Manager v. Lahore Electric Supply Company (LESCO) through Chief Executive and 3 others* (**2010 PTD 1295**).

4. Member, Inland Revenue Policy, FBR, appearing on behalf of the department alongwith the learned counsel for the department submitted that the payment of *advance tax* is an estimated amount of tax, therefore, unless the annual return is filed by the tax payer at the end of the year, it cannot be ascertained with any measure of certainty that the deductible amount of tax has been included in the payment of advance tax. It is best, the Member submitted, if SNGPL deposits the entire amount of deduction now and E&P applies for refund, if any, at the time of submitting the annual tax return. This is without prejudice to the option of recovering the said amount from the taxpayer under section 161(2).

5. I have gone through the arguments of the parties and have examined the concept of *advance tax* and *deduction of tax at source* under the Ordinance. The question that requires determination is the co-relation between advance tax and deduction of tax at source, the scope and meaning of section 161(1B) of the Ordinance and, in particular, whether advance tax paid for a quarter amounts to *paid in the meanwhile* for the purposes of section 161(1B) ?

6. Deduction of Tax at Source under Division III, Part V of Chapter X of the Ordinance is a species of *advance tax*, withheld at source by the person making the payment (deductor) to the taxpayer (payee or deductee). Section 152 deals with deduction of tax at source of non-residents including

Permanent Establishment of Non-resident Petroleum Exploration and Production Companies (E&P). In the present case, SNGPL (deductor) purchases gas from various E&Ps including PKP Explorations Ltd (payee/deductee) and under section 152(2A) deducts income tax at source at the rate of 3.5% of the gross amount payable. Earlier, the said deduction was provided under section 153 but enjoyed exemption under clause 46 of the Part IV of the 2nd Schedule to the Ordinance. However, vide Finance Act, 2012, Permanent Establishments of Non-Residents were moved under section 152 (dealing with non-residents) and as a result taken out of section 153. This legislative shift, however, failed to make any corresponding amendment in clause 46, which even today mentions section 153(1) and the term "permanent establishment of non-residents." As a consequence, the exemption stood withdrawn due to this legislative lacuna and according to the department an obligation was cast upon SNGPL to deduct tax from the payments made to E&P companies from 1st July, 2012 onwards.

7. In the wake of the above legislative amendment w.e.f. July, 2012 an obligation was cast upon SNGPL to deduct tax at source but it failed to do so for the period in question i.e., Tax Years 2013, 2014 and the first quarter of 2015. It is pointed out that E&Ps enjoy a <u>special tax year</u> under section 74 of the Ordinance which is from <u>1st January till 31st December</u> of the previous year.

8. According to the respondent department, failure to deduct tax at source rendered SNGPL (deductor-assesee) liable to tax for the above period. Impugned Show Cause Notice dated 19.5.2014 was served on the petitioner and during the pendency of the these petitions, Assessment Orders for all these

years were also passed under section 161 of the Ordinance on 9-6-2014 by Deputy Commissioner (IR), Enforcement-20, Zone-III, LTU, Lahore (Respondent No.1) .

9. Under section 161 of the Ordinance, if a deductor fails to collect tax under section 152 or collects it and fails to deposit it with the Commissioner under section 160, such a person becomes personally liable to pay the amount of tax to the Commissioner, who may pass an order to that effect and proceed to recover the same after granting an opportunity of hearing to the person[3]. Section 161(1B), however, provides a concession. If it is established that the tax that was to be deducted from the payment to the payee/deductee and was in the *meanwhile paid by that person (payee/deductee)*, no recovery shall be made from SNGPL (deductor-assesee) who failed to collect the tax. The deductor shall, however, be liable to pay *default surcharge* at the rate of 18% per annum from the date he failed to collect or deduct the tax to the date the tax was paid. The taxpayer (payee/deductee) whose tax has to be deducted at source avails the benefit of the said deduction at the time of payment of advance tax under section 147. The jurisprudence evolved over the years regarding the liability of a deductor-assesse in default in case of non-deduction is in consonance with the above provision. Reliance is placed on *CIT v. Marghalla Textile Mills Ltd.* (**2008 PTD 1982**) wherein it was held:-

> An assessee/payer cannot be held [as] an assessee in default, for non-deduction from a taxpayer, before whom an exemption certificate is produced or an order of an authority in hierarchy of Income Tax Department is produced. So far the case of recipient who has not

[3] section 161(1)

> produced the certificate, his payment shall be amenable to deduction of advance tax. The recipient, who has himself paid the taxes, the withholding agent cannot be held as defaulter to the extent of non-deduction. However, it is subject to penalty under section 86 of the late Income Tax Ordinance, 1979. *(emphasis supplied)*

Reliance is also placed on *Messrs Continental Chemical Co. (Pvt.) Ltd. v. Pakistan and others* **(2001 PTD 570)** and *Karachi Port Trust, Karachi v. Commissioner Inland Revenue, Karachi* **(2011 PTD 1996)**. The same view finds support in the Indian jurisdiction in the following manner:-

> "To declare a deductor, who failed to deduct the tax at source, as an assessee in default, the condition precedent is that the payee has also failed to pay tax directly. The Allahabad High Court, on a harmonious construction of the provisions of ss 190, 191 and 201, held that the fact that the payee had failed to pay tax directly is a foundational and jurisdictional fact. It is only after finding that the payee had failed to pay tax directly, can the deductor be deemed to be an assessee in default in respect of such tax…In a reverse situation, where no tax is deducted or there is shortfall in deduction by the deductor-assessee but the payee has paid tax on the income earned, no tax shall be once again recovered from the deductor-assessee. However, the deductor-assessee will be liable to pay interest under s 201 (1A) for the period during which tax remained unpaid.[4]

The question that requires further elaboration in the facts and circumstances of the instant case is the nature and character of

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[4] Kanga & Palkhivala's, *The Law and Practice of Income Tax,* Tenth Edition, Volume II, p. 2495 (also see for reference Jagran Prakashan Ltd. v. DCIT 345 ITR 288 and *Hindustan Coca Cola Beverages P. Ltd. v CIT*, AIR 2007 SC 2930).

Advance Tax to the extent whether it can pass for payment of tax by the payee/deductee in terms of section 161(IB) of the Ordinance, especially when the payee/deductee has not availed any tax credit in the said quarter.

10. The concept of Advance Tax has been explained by *Palkhivala* in the following manner:-

> "Under the basic scheme of this Act, the subject of charge is the income of the previous year and not the income of the assessment year; in other words, the tax is assessed and paid in the next succeeding year upon the results of the year before. These sections mark a departure from that basic scheme. They rest on the principle of 'pay as you earn', i.e. paying tax by installments in respect of the income of the very year in which the tax is paid." (Reliance Purshottamdas v. CIT 48 ITR (SC) 206, 211) *(emphasis supplied.)*[5]

Advance tax is paid quarterly and is structured on the basis of the under-mentioned formula:

(A x B/C) – D

"A" in the above formula is the taxpayer's turnover for the *quarter*, while "D" is the tax paid in the *quarter* for which a tax credit is allowed under section 168 (this includes deduction of tax at source in question under Division III, Part V of Chapter X of the Ordinance). While B and C represent the tax assessed of the taxpayer for the latest tax year and taxpayers turnover for the latest tax year, respectively. Section 147(7) provides that *"provisions of this Ordinance shall apply to any advance tax due under this section as if the amount due were tax due under*

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[5] Kanga & Palkhivala's *The Law And Practice of Income Tax* – Tenth Edition, Volume II, p. 2525. Also see *Messrs Riaz Bottlers Pvt. Ltd. through Tax Manager v. Lahore Electric Supply Company (LESCO) through Chief Executive and 3 others* (**2010 PTD 1295**).

an assessment order." Advance Tax due in a quarter has been equated with an amount of tax due under an assessment order. In other words, the amount of advance tax in a quarter, for all practical purposes, attains the status of final amount of tax due in that quarter as it is a definite amount calculable on the basis of a statutory formula. This view gets reinforced when the Ordinance equates this quarterly payment or intimation of advance tax with an *assessment order*. In the wake of section 147(7) of the Ordinance, the department is to consider the amount of advance tax due as tax due under an assessment order but has no locus or authority to doubt, suspect or dispute the quantum and the veracity or sanctity of the payment of advance tax paid in a particular quarter for the purposes of section 161(1B). In this background, once the taxpayer (payee/deductee) has paid advance tax for the quarter and categorically stated that no tax credit has been availed for the deduction of tax at source i.e., component D in the abovementioned formula, it will be assumed that the amount of tax to be deducted by SNGPL has been duly paid by the taxpayer and will qualify to be the payment paid in the meanwhile under section 161(1B) of the Ordinance.

11. As discussed above, once the payment has been made by the payee, the amount of tax that SNGPL failed to deduct cannot be recovered from SNGPL, except the imposition of *default surcharge* penalizing the failure to deduct.

12. In the triangular relationship between the *tax regulator* (FBR), the *payee/deductee* and the *deductor*, after *advance tax* has been paid by the payee/deductee, the onus of its correctness shifts onto the payee/deductee and the withholding agent (deductor-assesse) exits this triangular equation. Any short or

incorrect payment of advance tax will invoke the departmental remedy against the payee/deductee. At the end of the tax year, the department can impose default surcharge under section 205 of the Ordinance if the advance tax reflects less than 90% of the tax due that year.

13. The reasoning of the impugned Show Cause Notice and the subsequent Assessment Orders is based on the assumption that the payment of advance tax, *per se*, is an *estimate* and, therefore, it cannot with certainty and exactness reflect the amount of tax to be deducted at source. The concept of *estimation* which finds mention in sub-sections (4A) and (6) of section 147 is linked with external variables (discussed below) and has no nexus with the calculation of advance tax for the quarter, which is based on a statutory formula with clear and defined components under section 147(4). Therefore, the quantum of advance tax assessed and paid under the formula is final for the purposes of a particular quarter and constitutes payment for the purposes of section 161(IB). Some of the external variables which form the basis of the *estimation* of advance tax are: i) capital investment during the year due to which the taxpayer is entitled to initial allowance (section 23) thus reducing the income for the year *vis-a-vis* proportion of tax to turnover of the preceding year; ii) Capital investment generating tax credit (section 65B); iii) reduction of corporate tax rate (like it has happened during last two years during which corporate tax rate has been brought down from 35% to 33%); iv) donations to funds established by Government e.g. earthquakes, IDPs.; v) Adoption of group taxation / group relief during the year for utilization of losses of subsidiaries, etc. Similarly, variables enhancing the tax liability for the year *vis-a-vis* proportion of tax to turnover: i) increase in tax rate for

AOPs whereby highest slab rate taken from 25% to 35%; ii) taxpayer until previous year was paying lower tax (minimum tax u/s 113) due to available losses which are no longer available having been consumed or lapsed and taxpayer now is liable to pay full tax; iii) previously tax liability was lower like on account of payment of donations (unusual item) which is non-existent during current year; iv) last year's liability was exceptionally less on account of tax credit (section 65B) which is not available during current year; etc. etc. These variables, therefore, have no bearing on the sanctity or quantification of *advance tax* paid in the earlier quarters. More importantly, the amount of tax credit to be deducted from the formula (under component "D"), which includes and mirrors the amount to be deducted at source by the deductor (SNGPL) is not affected by enhancement or reduction of tax due at the end of the year. It is reiterated that the concept of *estimation* attached to advance tax has no bearing on quarterly payments of advance tax, which on their own are final payments calculated on the basis of a statutory formula. The impugned recovery of the deductible tax from SNGPL after the taxpayer (payee/deductee) has paid the advance tax for that quarter, tarnishes the veracity and sanctity of the concept of advance tax and more importantly the foundational theme of self-assessment on which the Ordinance rests.

14. Without prejudice to the above, impugned recovery made from a payee or the deductor-assessee, inspite of the *advance tax* having been paid, without deducting allowable tax credit, in a particular quarter, amounts to depriving the taxpayer (payee) or the deductor (withholding agent) of their property for a year without any plausible justification. This deprivation results in unjustly enriching and benefiting the department. *Unjust*

enrichment is retention of a benefit by a person that is unjust or inequitable. The Supreme Court of Canada has recently taken the opportunity of reviewing the law regarding unjust enrichment in *Garland* v. *Consumers' Gas Co*[6]. , wherein Iacobucci J held: "As a general matter, the test for unjust enrichment is well established in Canada. The cause of action has three elements: (1) an enrichment of the defendant; (2) a corresponding deprivation of the plaintiff; and (3) an absence of juristic reason for the enrichment ..." Thus, for recovery to lie, something must have been given, whether goods, services or money. The thing which is given must have been received and retained by the defendant, and the retention must be without juristic justification[7]. One of the more prominent statements of the principle of unjust enrichment includes the early and oft-repeated dictum of Lord Mansfield in *Moses v. Macferlan*[8] : "the gist of this kind of action is, that the defendant, upon the circumstances of the case, is obliged by the ties of natural justice and equity to refund the money[9]." Another is that of Lord Wright in *Fibrosa Spolka Akcyjna v. Fairbairn Lawson Combe Barbour Ltd*[10]: "... any civilized system of law is bound to provide remedies for cases of what has been called unjust enrichment or unjust benefit, that is to prevent a man from retaining the money of or some benefit derived from another which it is against conscience that he should keep[11]." The American *Restatement of the Law of Restitution: Quasi Contracts and Constructive Trusts*, 1937, states the principle of unjust enrichment in the following simple terms: "A person

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[6] 2004 SCC 25
[7] *Peel (Regional Municipality) v. Canada* (1992), 98 D.L.R. (4th) 140 (S.C.C.), at p.154.
[8] [1558-1774] All E.R. Rep. 581 (K.B.)
[9] ibid p. 585
[10] [1943] A.C. 32(H.L.)
[11] Ibid p.61

who has been unjustly enriched at the expense of another is required to make restitution to the other." And, one of the leading Commonwealth texts on restitution elaborates on the notion as follows: "[The principle of unjust enrichment] presupposes three things. First, the defendant must have been enriched by the receipt of a *benefit*. Secondly, that benefit must have been gained *at the plaintiff's expense*. Thirdly, it would be *unjust* to allow the defendant to retain that benefit...[12]" "Unjust enrichment occurs when a person retains money or benefits which in justice, equity and good conscience, belong to someone else…The doctrine of unjust enrichment, therefore, is that no person can be allowed to enrich inequitably at the expense of another. A right of recovery under the doctrine of "unjust enrichment" arises where retention of a benefit is considered contrary to justice or against equity.[13] Reliance with advantage is also placed on <u>*Messrs Pfizer Laboratories Limited v. Federation of Pakistan and others*</u> (**PLD 1998 SC 64**). Unjust enrichment is, *inter alia*, anchored in our fundamental premabular constitutional value of <u>*economic justice*</u>. Our constitution abhors any form of economic exploitation. In this case, the prime tax regulator is trying to recover an amount of tax which has already been paid (and there is no reason to suspect the same). In any case if there is shortfall at the end of the year, it can be recovered with a heavy default surcharge from the payee/deductee. FBR has given no plausible or legal justification for suspecting that the amount of *advance tax,* paid by the payee, is in any way short or insufficient because the enhancement or reduction of advance tax at the end of the tax

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[12] Goff and Jones, *The Law of Restitution*, 6th Ed., (London: Sweet & Maxwell, 2002), at p.17, para 1-016.
[13] *Sahakari Khand Udyog Mandal Ltd. v. CCE & Customs* **(2005) 3 SCC 738** at748.

year has no co-relation with the amount of advance tax paid in a quarter. The impugned notice for recovery promotes *unjust enrichment* and offends the constitutional principle of *economic justice*. For reference, reliance is placed on *Ikram Bari and 524 others v. National Bank of Pakistan through President and another* (**2005 SCMR 100)** and *Pakistan Tobacco Company Ltd. and another v. Federation of Pakistan through Secretary, Ministry of Commerce, Islamabad and 3 others* **(1999 SCMR 382).**

15. Another aspect of assessment under section 161 is the obligation of the department to *establish* that the deductible amount has not been paid in the meanwhile under section 161(1B). In order to establish this, an opportunity of hearing is required to be provided to the taxpayer (payee) i.e., E&P in this case. This complies with the requirement of Articles 4 and 10A of the Constitution and the jurisprudence settled by the superior courts (reliance for convenience is placed on *Mst. Zahida Sattar and others v. Federation of Pakistan and others* **(PLD 2002 SC 408**). The assessment order presented in Court during the proceedings, *inter alia*, fails to comply with this constitutional requirement.

16. In the present case, SNGPL is only liable for default surcharge but not for the amount of tax as the *advance tax* has been paid by the taxpayer (payee/deductee). It is noted that as for the Tax Year 2013 the annual return has been filed, the department in the light of the *Riaz Bottlers case* (supra) have only charged default surcharge but for the remaining tax period has charged the amount of tax from SNGPL because the annual return has yet not been filed but only tax deposit receipts have

been furnished. As discussed above, payment of *advance tax* by taxpayer fully meets the requirement under section 161(1B).

17. For the above reasons both these petitions are allowed and Show Cause Notice and the subsequent Assessment Order dated 9.6.2014 are hereby set aside as being unconstitutional and without lawful authority.

18. This judgment decides the instant petition, as well as, connected writ petition No.16046/2014 as both these cases raise common questions of law and facts.

(Syed Mansoor Ali Shah)
Judge

*M. Tahir**

APPROVED FOR REPORTING