



DIRECTOR LAW-I, LAHORE.

No. 21/APS

Dated:- 20/11/2019

To

The Member (IR-Operations),
Federal Board of Revenue
Islamabad.

Through Proper Channel

SUBJECT:-

JUDGMENT PASSED IN W.P.NO.21245/2014 TITLED M/S NISHAT MILLS LIMITED VS. FEDERATION OF PAKISTAN - RECOVERY OF INPUT TAX ADJUSTMENT CLAIMED U/S 8(1)(h) & (i) OF THE SALES TAX ACT, 1990 - CIRCULATION OF - REQUEST REGARDING -

Kindly refer to the subject cited above.

The Petitioner challenged the vires of Section 8(1)(h) and (i) of the Sales Tax Act, 1990 ("Act") being ultra vires to the Constitution of Islamic Republic of Pakistan, 1973. The Petitioners contend that they are engaged in various different businesses, are taxpayers who are registered with the sales tax department and are entitled to input tax adjustment in terms of Section 7 of the Act. They are aggrieved by Section 8(1)(h) and (i) of the Act as input tax adjustment has been done away on goods having direct nexus with the taxable activity of the registered person. This is contrary to the provisions of the Act and the substantive right of input tax adjustment under Section 7 of the Act. It is also against the fundamental rights of the Petitioners to do their business and reduce investments.

The undersigned argued the case before the Honourable Lahore High Court, Lahore in favour of the Department and the honourable High Court passed its judgment on vires as under:-

"11. After hearing the learned counsel for the parties at great length, I find merit in the arguments of the Respondents as the goods utilized by the Petitioners which fall under Section 8(1)(h) and (i) of the Act are not part of the supply chain and in most of the cases not directly related to taxable supplies. Although the goods are bought for the improvement of building or business but it is not directly related to the taxable supply of the registered person, not is it part of the supply chain. At best the Petitioners are able to show that the purchase of the goods in question is

related to the improvement of their general business, however there is no direct nexus to or relation with taxable supplies. A registered person has to establish a direct nexus between the goods adjustment which is claimed on to the taxable supply and taxable activity. In these cases there is no direct nexus to taxable supply as the goods are not part of the supply chain. Rather they are utilized by the Petitioners for their own internal consumption, which their claim is relevant as it enhances and improves their taxable activity. However, there is no merit in this argument as this does not suggest that the restriction of Section (1)(h) and (i) is unreasonable or confiscatory. Furthermore the Petitioners contend that they have a substantive right to claim input tax adjustment, however as already stated this right is subject to the restrictions given in Section 8 of the Act and as such Section 8(1)(h) and (i) in no manner infringes upon the rights of the Petitioners to claim input tax adjustment which is directly related to the supply chain, which essentially means that there must be a continuation of the transaction of the taxable supply between buyers and the sellers. Although the goods stipulated in Section 8(1)(h) and (i) are used for the improvement of the businesses of the Petitioners or for improvement in their efficiency that use does not count towards being part of the supply chain. Therefore the Petitioners have not been denied their proprietary right to claim input tax adjustment. This right is based on the restrictions under Section 8 in which the underline feature is that the goods remain part of the supply chain for claiming of input tax adjustment. Hence this is a reasonable restriction and it does not deprive the registered person of any amount due to it."

In view of the above, the honourable Lahore High Court vide its judgment dated 24.0.2019, dismissed the writ petition of the petitioner. (Copy of judgment enclosed).

It is requested that the said judgment may kindly be circulated amongst all field formations for recovery of input adjustment claimed by the registered persons against goods covered u/s 8(1)(h) & (i) of the Sales Tax Act, 1990.

Encl:- a.a.


(ISHTIAQ AHMED KHAN)
Director Law, Lahore

Copy to:-

1. The Member Legal, Federal Board of Revenue, Islamabad for information.
2. The SA to Chairman, Federal Board of Revenue, Islamabad for information.

Stereo. H C J D A 38.

Judgment Sheet
IN THE LAHORE HIGH COURT AT LAHORE
JUDICIAL DEPARTMENT

WP No.21245/2014

Nishat Mills Limited
Versus
Federation of Pakistan etc.

J U D G M E N T

Date of Hearing	24.10.2019
Petitioners By the following Advocates:	Mr. Imtiaz Rashid Siddiqui, Mr. Shehryar Kasuri, Mr. Raza Imtiaz Siddiqui, Mr. Qadeer Kalyar, Mr. M. Hamza Sheikh and Mr. Jamshed Alam, Mr. Mansoor Usman Awan, Mr. Mehmood Ahmed, Rana Muhammad Afzal, Mr. Waseem Ahmad Malik, Mr. Tariq Rashid, Mr. Tariq Rashid, Advocate vice Mr. Shahbaz Butt, Mr. Abuzar Hussain, Mr. Asif Imran Awan, Mr. H.M. Majid Siddiqui, Mr. Muhammad Raza Qureshi, Mr. Mustafa Kamal, Mr. Khubaib Ahmad, Mr. Qadeer Kalyar, Mr. Habib ur Rehman, Mr. Khalil ur Rehman and Mr. Muhammad Asif.
Respondents By the following Advocates:	Chaudhary Ishtiaq Ahmad Khan, Additional Attorney General for Pakistan, Ms. Ambreen Moeen, DAG, Dr. Ishtiaq Ahmad Khan, Director (Law) Federal Board of Revenue, Mr. Sarfraz Ahmad Cheema, Mr. Shahzad Ahmad Cheema and Malik Abdullah Raza, Mr. Saad Amir, Mrs. Kausar Parveen, Mr. Shaigan Ijaz Chadhar, Mr. Mahmood Ahmad Chaudhary, Mr. Muhammad Anwar Khan,

	Syed Zain-ul-Abidien, Mr. Ijaz Mehmood Chaudhary, Mr. Falak Sher Khan, Mian Faisal Naseer and Mr. Farrukh Ilyas Cheema, Ms. Riaz Begum and Mr. Waseem Akbar Malik, Advocates vice Chaudhary Muhammad Zafar Iqbal, Mr. Zafar Iqbal Bhatti and Mr. Muhammad Saad Ghazi, Mr. Shahid Sarwar Chahil and Chaudhary Muhammad Saleem.
--	--

Avesha A. Malik J: This common judgment decides the instant petition as well as connected Petitions detailed in Schedule "A" appended with the judgment as all Petitions raise common questions of law and facts.

2. The Petitioners challenge the vires of Section 8(1)(h) and (i) of the Sales Tax Act, 1990 ("Act") being ultra vires to the Constitution of Islamic Republic of Pakistan, 1973. The Petitioners contend that they are engaged in various different businesses, are taxpayers who are registered with the sales tax department and are entitled to input tax adjustment in terms of Section 7 of the Act. They are aggrieved by Section 8(1)(h) and (i) of the Act as input tax adjustment has been done away on goods having direct nexus with the taxable activity of the registered person. This is contrary to the provisions of the Act and the substantive right of input tax adjustment under Section 7 of the Act. It is also against the fundamental rights of the Petitioners to do their business and reduce investments.

3. Learned counsel for the Petitioners argued that the right to claim input tax adjustment from output tax of goods having a direct nexus with taxable supplies is a substantive right of a registered person and any deviation will enhance their liability and is also confiscatory in nature. The impugned provisions of the Act have denied adjustment on the goods mentioned in sub section 8(1)(h)

which are essential components of taxable activity. Learned counsel explained that input tax adjustment has been denied on goods used in, or permanently attached to, immovable property, such as building and construction materials, paints, electrical and sanitary fittings, pipes, wires and cables which are directly involved in the taxable activity. The counsel explained that the upkeep and maintenance of their factories involve the use of construction material, paints electrical and sanitary fittings, pipes, wires and cables which should be allowed for the purposes of input tax adjustment as they have a direct nexus with the taxable activity. In terms of Section 8(1)(i) no input tax adjustment has been given against vehicles falling in Chapter 87 of the First Schedule to the Customs Act, 1969. Parts of such vehicles, electrical and gas appliances, furniture, furnishings, office equipment (excluding electronic cash registers) are used in the running of business thereby having a direct nexus with taxable activity. Learned counsel further argued that in the previous regime vide SRO No.450(1)/2013 dated 27.5.2013 input tax adjustment was allowed on these items and it is only by way of the impugned amendments brought in the year 2015 through the Finance Act, 2015 that input tax adjustment has been denied. It is the case of the Petitioners that this is against the mandate of the law and fundamental rights as enshrined in the Constitution of Islamic Republic of Pakistan, 1973 and that it discourages investment in the country and infringes upon their rights to do business. Learned counsel places reliance on M/s Ghandhara Nissan Diesel Ltd. v. Collector, Large Tax-Payers Unit and 2 others (PTCL 2006 CL 673), Collector of Customs Sales Tax and Central Excise, etc. v M/s Sanghar Sugar Mills Ltd., Karachi etc. (PTCL 2007 CL 565), Collector of Sales Tax v. M/s Dhan Fibre Limited (2005 PTD 2012), Treet Corporation Ltd. through Company Secretary and others v. Federation of Pakistan through Ministry of Finance and others (2014 PTD 1285) and Pakistan International

WP No.21245/2014

Airlines Corporation through Secretary PIA v. Pakistan through Secretary, Islamabad and 2 others (2015 PTD 245).

4. Report and parwise comments have been filed by the Respondents. Learned Additional Attorney General for Pakistan argued that there is no unqualified right to input tax adjustment; that restrictions can be imposed provided that they are reasonable and fall within the mandate of the law. He argued that tax is imposed on the value added to the taxable supply, therefore if a Petitioner is spending money on renovation or construction of its building or premises and thereby using construction material, paints electrical and sanitary fittings, pipes, wires and cables that is not value addition of the taxable supply. Consequently it is not subject to input tax adjustment. In the same way if in the process of its business it is using vehicles, electrical and gas appliances, furniture, furnishings, office equipment, this is also not adding value to the taxable supply, hence no input tax adjustment is granted. Reliance is placed on Lahore Development Authority through D.G and others v. Ms Inrana Tiwana and others (2015 SCMR 1739) and Supreme Tube Industries (Pvt.) Limited v. Federation of Pakistan and others (2016 PTD 2058).

5. On behalf of the Respondent Federal Board of Revenue Dr. Ishtiaq Ahmad Khan, Director (Law) argued that the Petitioners are not entitled to the relief claimed. The basic spirit of Section 7 and 8 of the Act is to refund input tax for items which are part of the supply chain. No registered person has an unfettered claim to input tax adjustment which is recovered under Section 8 of the Act. He argued that since the intention of the legislature is to deny adjustment of input tax on certain goods, the Court should uphold the stance and the intent of the legislature and not replace it with the intent of the taxpayer. He also argued that the impugned sections are neither confiscatory nor against the spirit of the Act. It simply denies input tax adjustment against goods which do not have a direct nexus with the taxable

WP No.21245/2014

activity and are not part of the supply chain. He stated that it does not violate any fundamental right nor does it prejudice the right to do business as argued by the Petitioners. He argued that the goods listed in Section 8(1)(h) and (i) of the Act are not supplied further by the Petitioners. These items are used for their own consumption, hence the supply chain breaks, therefore they are not entitled to input tax adjustment. Reliance has been placed on Ittehad Chemicals Limited, Lahore v. Customs, Excise and Sales Tax Appellate Tribunal, Lahore through Chairman and another (2005 PTD 2067), Messrs AMZ Spinning and Weaving Mills (Pvt.) Ltd. through Manager v. Appellate Tribunal, Customs Sales Tax and Federal Excise, Karachi (2006 PTD 2821), Messrs Syntronics Limited, Industrial Estate, Hattar v. Additional Collector (ADJ) Customs, CE & Sales Tax Peshawar (2007 PTD 749) and Messrs Dewan Cement Ltd. through Authorized Representative v. Pakistan through Secretary Ministry of Finance, Revenue Division and Ex-officio Chairman, F.B.R., Islamabad and 2 others (2010 PTD 1717). Learned counsel for the Respondents adopts the arguments.

6. Heard and record perused. Since the vires of Section 8(1)(h) and (i) of the Act have been challenged, they are reproduced hereunder for ease of reference:

Tax credit not allowed. (1) Notwithstanding anything contained in this Act, a registered person shall not be entitled to reclaim or deduct input tax paid on

- (a) the goods or services used or to be used for any purpose other than for taxable supplies made or to be made by him;
- (b) any other goods or services which the Board with the approval of the Federal Minister incharge may, by a notification in the official Gazette, specify
- (c) the goods under sub-section (5) of section 3
- (ca) the goods or services in respect of which sales tax has not been deposited in the Government treasury by the respective supplier
- (caa) purchases, in respect of which a discrepancy is indicated by CREST or input tax of which is not verifiable in the supply chain
- (d) fake invoices;

- (e) purchases made by such registered person, in case he fails to furnish the information required by the Board through a notification issued under sub-section (5) of section 26
- (f) goods and services not related to the taxable supplies made by the registered person
- (g) goods and services acquired for personal or non-business consumption
- (h) goods used in, or permanently attached to, immoveable property, such as building and construction materials, paints, electrical and sanitary fittings, pipes, wires and cables, but excluding [pre-fabricated buildings and] such goods acquired for sale or re-sale or for direct use in the production or manufacture of taxable goods
- (i) vehicles falling in Chapter 87 of the First Schedule to the Customs Act, 1969 (IV of 1969), parts of such vehicles, electrical and gas appliances, furniture, furnishings, office equipment (excluding electronic cash registers), but excluding such goods acquired for sale or re-sale.

7. The Petitioners claim that they have a substantive right for input tax adjustment under Section 7 of the Act which is reproduced hereunder:

Determination of tax liability. (1) Subject to the provisions of sections 8 and 8B, for the purpose of determining his tax liability in respect of taxable supplies made during a tax period, a registered person shall, subject to the provisions of section 73, be entitled to deduct input tax paid or payable during the tax period for the purpose of taxable supplies made, or to be made, by him from the output tax, excluding the amount of further tax under sub-section (1A) of section 3, that is due from him in respect of that tax period and to make such other adjustments as are specified in Section 9

Provided that where a registered person did not deduct input tax within the relevant period, he may claim such tax in the return for any of the six succeeding tax periods.

(2) A registered person shall not be entitled to deduct input tax from output tax unless,

- (i) in case of a claim for input tax in respect of a taxable supply made, he holds a tax invoice in his name and bearing his registration number, in respect of such supply for which a return is furnished

Provided that from the date to be notified by the Board in this respect, in addition to above, if the supplier has not declared such supply in his return or he has not paid amount of tax due as indicated in his return;

- (ii) in case of goods imported into Pakistan, he holds bill of entry or goods declaration in his name and showing his sales tax registration number, duly cleared by the customs under section 79, section 81 or section 104 of the Customs Act, 1969 (IV of 1969);

(iii) in case of goods purchased in auction, he holds a treasury challan, in his name and bearing his registration number, showing payment of sales tax;

(3) Notwithstanding anything in sub-sections (1) and (2), the Board with the approval of the Federal Minister-in-charge may, by a special order, subject to such conditions, limitations or restrictions as may be specified therein allow a registered person to deduct input tax paid by him from the output tax determined or to be determined as due from him under this Act.

(4) Notwithstanding anything contained in this Act or rules made there under, the Board with the approval of the Federal Minister-in-charge may, by notification in the official gazette, subject to such conditions, limitations or restrictions as may be specified therein, allow a registered person or class of persons to deduct such amount of input tax from the output tax as may be specified in the said notification.

8. A bare reading of the Section 7 makes it clear that the said Section is subject to the provisions of Section 8 of the Act, therefore there is no unqualified right to claim input tax adjustment as all such adjustments are subject to the restrictions given in Section 8 of the Act. Section 7 requires that for the purposes of determining the tax liability with respect to taxable supplies made during a tax period, a registered person can deduct the sales tax paid at the time of sales (output tax) from the sales tax paid at the time of purchase (input tax) as this differential is the value added to the price of the goods. In this way taxable supplies are subject to sales tax, when bought and sold, in the supply chain through a series of different transactions. It is an ongoing process where each person in the supply chain pays sales tax. Section 3 is the charging section, which requires a registered person who makes taxable supplies, in the course of a taxable activity, to pay sales tax. So sales tax is paid when a taxable supply is made in furtherance of a taxable activity, meaning thereby that sales tax is to be paid where the transaction falls within the ambit of supply of goods in furtherance of its business.

9. The entire dispute revolves around the question whether the goods defined in Section 8(1)(h) and (i) are taxable supply such that it may be deemed as value addition for the purposes of collecting input

tax adjustment. The Petitioners claim that the goods mentioned in Section 8(i) (h and i) are subject to input tax adjustment as over time the Petitioners keep investing in their businesses by spending money on building and construction materials, paints, electrical and sanitary fittings, pipes, wires and cables. The improvements made directly impact the taxable activity hence it adds value to the taxable supply as it improves the quality and efficiency of the business of the Petitioners. Accordingly they should be allowed to claim input tax adjustment and the restriction imposed is without justification. In the same way, the vehicles used during the course of business such as loaders and dumpers are also part of the taxable activity and the Petitioners should be allowed to collect input tax adjustment against these vehicles notwithstanding the fact that the vehicles themselves are not subject to further sale.

10. The Respondents however dispute this contention on the ground that the Petitioners are using these goods for the purposes of improving their own business and the goods are no longer part of the supply chain therefore they are not for all intents and purposes *taxable supplies* since the goods are not sold further and consequently the supply chain breaks. Therefore, the Petitioners are not entitled to input tax adjustment. The Respondents have also explained the reasons for the insertion of Section 8(1)(h) and (i) of the Act which is to prevent fraudulent claims for input tax adjustment as there is no way for the Respondents to verify to what extent such goods have been utilized in the supply chain and whether in fact they have been utilized as stated by the registered person. Therefore in order to prevent fraudulent claims of input tax adjustment, the legislature inserted Section 8(1)(h) and (i) which clarifies that where the goods are used by the Petitioners in the form of construction, maintenance, renovation of their own facility or in the form of vehicles, electrical and gas appliances, furniture, furnishings, office equipment for their internal consumption

as it is not part of the supply chain and not directly related to the taxable supplies. In this way the registered person claims input tax adjustment on those goods which are part of the supply chain and are directly related to the taxable supplies.

11. After hearing the learned counsel for the parties at great length, I find merit in the arguments of the Respondents as the goods utilized by the Petitioners which fall under Section 8(1)(h) and (i) of the Act are not part of the supply chain and in most of the cases not directly related to taxable supplies. Although the goods are bought for the improvement of building or business but it is not directly related to the taxable supply of the registered person, not is it part of the supply chain. At best the Petitioners are able to show that the purchase of the goods in question is related to the improvement of their general business, however there is no direct nexus to or relation with taxable supplies. A registered person has to establish a direct nexus between the goods adjustment which is claimed on to the taxable supply and taxable activity. In these cases there is no direct nexus to taxable supply as the goods are not part of the supply chain. Rather they are utilized by the Petitioners for their own internal consumption, which their claim is relevant as it enhances and improves their taxable activity. However, there is no merit in this argument as this does not suggest that the restriction of Section (1)(h) and (i) is unreasonable or confiscatory. Furthermore the Petitioners contend that they have a substantive right to claim input tax adjustment, however as already stated this right is subject to the restrictions given in Section 8 of the Act and as such Section 8(1)(h) and (i) in no manner infringes upon the rights of the Petitioners to claim input tax adjustment which is directly related to the supply chain, which essentially means that there must be a continuation of the transaction of the taxable supply between buyers and the sellers. Although the goods stipulated in Section 8(1)(h) and (i) are used for the improvement of the businesses

of the Petitioners or for improvement in their efficiency that use does not count towards being part of the supply chain. Therefore the Petitioners have not been denied their proprietary right to claim input tax adjustment. This right is based on the restrictions under Section 8 in which the underline feature is that the goods remain part of the supply chain for claiming of input tax adjustment. Hence this is a reasonable restriction and it does not deprive the registered person of any amount due to it. ✓

12. In WP No.36780/15 and 36781/15, the Petitioners imports chillers which are used directly in providing taxable supplies. Learned counsel for the Petitioners argued that these goods are used in the retail business as the cold drinks sold by the Petitioners cannot be sold without these chillers, hence they are in fact involved in the sale and re-sale of the goods. Learned counsel argued that to the extent of his cases the matter in issue stands decided in Coca-Cola Beverages Pakistan Ltd. v. Customs, Excise and Sales Tax Appellate Tribunal and others (2017 PTD 2380) wherein the Court decided the issue of whether placement of the Appliances, i.e. visi-coolers and chest-coolers, at retail outlets by the registered persons for the sale of their goods constitutes "supply" in terms of section 2(33) of the Act. The Court concluded that in order to determine whether input tax is admissible in a particular case it has to be seen whether the goods were used in relation to the taxable supplies. The Court concluded that it is not necessary that those goods should be an integral part of the taxable supply, however, the registered person is required to establish that its goods are used for the purposes of taxable supplies. With respect to the Petitioner's chillers, it was held that there is no denying fact that the appliances facilitate the sale of the products, hence they are directly related to taxable supplies. Learned counsel argued that on the strength of this judgment, the Petitioners are entitled to input tax adjustment under Section 8(1) and (i) of the Act and cannot be denied

the same. Since this issue stands decided, hence the Petitioners are entitled to the benefit of the said judgments. Therefore WP Nos.36780/15 and 36781/2015 are disposed of with the direction to Respondent No.2 for consideration of input tax adjustment for the relevant period.

13. Under the circumstances, no case for interference is made out. The petitions stand dismissed. ✓

(AYESHA A.MALIK)
JUDGE

Approved for Reporting ✓

JUDGE