

**IN THE HIGH COURT OF BALOCHISTAN QUETTA.**

C.P. No. 2058/2022 ✓

Quetta Chambers of Commerce & Industry, through its representative having registered office at QCCI Building Zarghoon Road, Quetta.

.....Petitioner

**VERSUS**

1. Federation of Pakistan, through Secretary Revenue, Constitution Avenue, Islamabad
2. Chief Commissioner Inland Revenue, Regional Tax Office, Spinny Road, Quetta. ....Respondents

**CONSTITUTIONAL PETITION UNDER ARTICLE 199 OF THE CONSTITUTION OF ISLAMIC REPUBLIC OF PAKISTAN, 1973**

C.P. No. 958/2023 ✓

Usman Zaheer, S/o Zahoor Tareen, R/o BDA Colony Qawary Road Quetta. ....Petitioner

**VERSUS**

1. Federation of Pakistan through Secretary Revenue Division Federal Secretariat Islamabad.
2. Federal Board of Revenue, through its Chairman, Constitutional Avenue, Islamabad.
3. Federal Ministry of Law & Justice through its Secretary, Federal Secretariat, Islamabad.
4. Federal Board of Revenue, through its Chief Commissioner, RTO, Quetta.
5. Province of Balochistan through Secretary Finance, Balochistan Secretariat, Quetta. ...Respondents

**CONSTITUTIONAL PETITION UNDER ARTICLE 199 OF THE CONSTITUTION OF ISLAMIC REPUBLIC OF PAKISTAN, 1973**

**J U D G M E N T**

**In C.P. No.2058 of 2022.**

Date of hearing: 24.05.2024.

Announced on: 31.05.2024.

Petitioner by:

M/s Pervaiz Khan, Syed Mohibullah and Nasrullah Kakar, Advocates.

Respondent No.1 by:

Mr. Khushal Khan Kasi, Assistant Attorney General.

Respondent No.2 by:

Barrister Iftikhar Raza, Advocate, assisted by Mr. Rehmattullah Durrani, Commissioner Inland Revenue, Quetta.

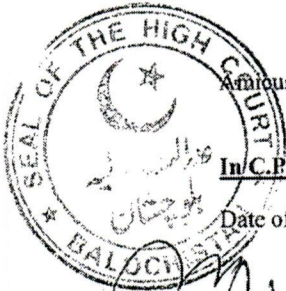
Amicus Curiae:

M/s Amanullah Kanrani and Kamal Siddiqui, Advocates.

**In C.P. No.958 of 2023.**

Date of hearing: 24.05.2024.

Announced on: 31.05.2024.



Petitioner by: Mr. Usama Zaheer, Advocate, petitioner in person.

Respondent Nos.1 to 4 by: Mr. Khushal Khan, Assistant Attorney General.

Respondent No.5 by: Mr. Zahoor Ahmed Baloch, Additional Advocate General (AAG) assisted by Barrister Iftikhar Raza, Advocate and Mr. Rehmatullah Durrani, Commissioner Inland Revenue, Quetta.

Amicus Curiae: M/s Amanullah Kanrani and Kamal Siddiqui, Advocates.

**MUHAMMAD HASHIM KHAN KAKAR, CJ.**- The petitioners in both the above captioned constitutional petitions have challenged the provision of section 7E of the Income Tax Ordinance, 2001 ("**the Ordinance**") inserted through the Finance Act, 2022, on the basis that it is ultra vires the constitution of Islamic Republic of Pakistan, 1973 ("**the Constitution**"), for being beyond the competence of the Federal Legislature, and for being discriminatory and confiscatory violating constitutional rights, hence liable to be struck down.

2. At the very outset, it would not be out of place to mention that the vires of the impugned provision was challenged before different High Courts i.e. the High Court of Sind, the Lahore High Court, Islamabad High Court as well as Peshawar High Court. The Hon'ble Sind and Lahore High Courts upheld the vires of section 7E, whereas the Hon'ble High Courts of Peshawar and Islamabad have struck down the law for being ultra vires.

3. While following the principle of avoiding the unnecessary repetition of cases facts and mentioning the contentions raised by the learned counsel for the parties and eschewing overly detailed scholarly discussion in judgments which has several key justifications rooted in judicial efficiency, clarity, and respect for precedents, we directly come to the core legal questions at hand to ensure a more efficient use of judicial time and resources.



We have heard Mr. Khushal Khan AAG, Mr. Pervaiz Khan, Mr. Usama Zaheer, Iftikhar Raza, Mr. Amanullah Kanrani, Mr. Rehmatullah, Commissioner and also perused the relevant Articles of the Constitution and provisions of the Ordinance. We deem it proper to reproduce the impugned provision of 7E and

0376

analyze it in the light of arguments of both the parties and the related Articles of the Constitution, provisions of the Ordinance and the case laws. The provisions of section 7E are as follows:

**"7E. Tax on deemed income.-** (1) For tax year 2022 and onwards, a tax shall be imposed at the rates specified in Division VIII C of Part-I of the First Schedule on the income specified in this section.

(2) A resident person shall be treated to have derived, as income chargeable to tax under this section, an amount equal to five percent of the fair market value of capital assets situated in Pakistan held on the last day of tax year excluding the following, namely:—

(a) one capital asset owned by the resident person;

(b) self-owned business premises from where the business is carried out by the persons appearing on the active taxpayers' list at any time during the year;

(c) self-owned agriculture land where agriculture activity is carried out by person excluding farmhouse and land annexed thereto;

(d) capital asset allotted to —

(i) a Shaheed or dependents of a shaheed belonging to Pakistan Armed Forces;

(ii) a person or dependents of the person who dies while in the service of Pakistan armed forces or Federal or provincial government;

(iii) a war wounded person while in service of Pakistan armed forces or Federal or provincial government; and

(iv) an ex-serviceman and serving personal of armed forces or ex-employees or serving personnel of Federal and provincial governments, being original allottees of the capital asset duly certified by the allotment authority;

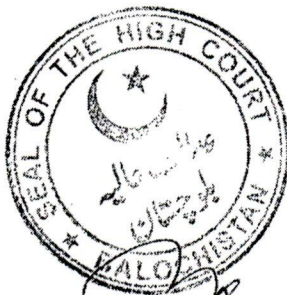
(e) any property from which income is chargeable to tax under the Ordinance and tax leviable is paid thereon;

(f) capital asset in the first tax year of acquisition where tax under section 236K has been paid;

(g) where the fair market value of the capital assets in aggregate excluding the capital assets mentioned in clauses (a), (b), (c), (d), (e) and (f) does not exceed Rupees twenty-five million;

(h) capital assets owned by a provincial government or a local government; or

(i) capital assets owned by a local authority, a development authority, builders and developers for land development and construction, subject to the



03/10

condition that such persons are registered with Directorate General of Designated Non-Financial Businesses and Professions.

Provided that the exclusions mentioned at clauses (a), (e), (f) and

(g) of this sub-section shall not apply in case of a person not appearing in the active taxpayers' list, other than persons covered in rule 2 of the Tenth Schedule.

(3) The Federal Government may include or exclude any person or property for the purpose of this section.

(4) In this section—

(a) —capital asset means property of any kind held by a person,

whether or not connected with a business, but does not include —

(i) any stock-in-trade, consumable stores or raw materials held for the purpose of business;

(ii) any shares, stocks or securities;

(iii) any property with respect to which the person is entitled to a depreciation deduction under section 22 or amortization deduction under section 24; or

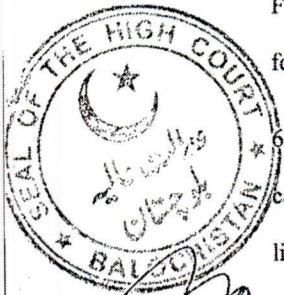
(iv) any movable asset not mentioned in clauses (i), (ii) or (iii);

(b) —farmhouse means a house constructed on a total minimum area of 2000 square yards with a minimum covered area of 5000 square feet used as a single dwelling unit with or without an annex.

Provided that where there are more than one dwelling units in a compound and the average area of the compound is more than 2000 square yards for a dwelling unit, each one of such dwelling units shall be treated as a separate farmhouse."

5. The above provision of the Ordinance creates a charge on certain resident citizens holding immovable properties through creating legal fiction by taking 5% of value of such property as "deemed income" and imposing income tax @20% on such income. This charge has been created in pursuance of Entry 47 of the Fourth Schedule (the Federal Legislative List) to the Constitution which provides for taxes on income other than agricultural income.

6. Although taxation is the basic attribute of sovereign authority and a state cannot be run without imposition and collection of taxes however power to tax is limited only by constitutional provisions defining the jurisdiction of the respective Legislatures. In a Federal State like Pakistan the power of the state to impose



276

taxes is to pass some basic tests: Firstly, whether the tax imposed is clearly provided by the Constitution in the Federal Legislative List. Secondly, whether imposition of such tax by the Federation does not encroach upon powers of the Federating Units to impose taxes. Since impugned tax is imposed through legal fiction hence another test is also to be passed by section 7E of the Ordinance i.e. whether such legal fiction is within the four corners of the existing tax law and supported by the body of case laws or not. Last but not the least, whether imposition of such tax does or does not violate rights of the citizens protected by the Constitution. We will examine the impugned provision of 7E of the Ordinance in the light of these principles.

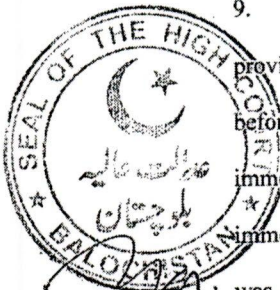
7. It is evident that through the impugned provision of 7E the Federation is imposing tax on immovable properties. This brings us to the current Entry 50 of the Federal Legislative List which is as follows:

*"50. Taxes on the capital value of the assets, not including taxes on immovable property."*

8. Before commenting we deem it appropriate to mention that the above Entry in present form is result of the 18<sup>th</sup> Amendment to the Constitution which devolved certain taxing powers from the Federal Government to the Provinces which includes "sales tax on services" and "taxes on immovable properties". Before 18<sup>th</sup> Amendment the Entry 50 of the Federal Legislative List read as follows:

*"50. Taxes on the capital value of the assets, not including taxes on capital gains on immovable property"*

9. When comparing the pre-18<sup>th</sup> Amendment and post-18<sup>th</sup> Amendment provisions of Entry 50 of the Federal Legislative List one can easily observe that before 18<sup>th</sup> Amendment the Federating Units could impose tax on capital gain on immovable properties whereas the Federation had powers to impose taxes on immovable properties other than on capital gain on such immovable properties. It was for this reason that under Section 37 of the Ordinance relating to tax on capital gains, the immovable properties were specifically excluded under section



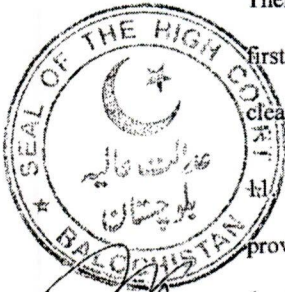
0276

37(5)(c) of the Ordinance from the purview of assets for the purpose of income under the head "capital gains". This indicates that the Federation was aware of the fact that immovable properties cannot be taxed under the Ordinance. Astonishingly after passing of 18<sup>th</sup> Amendment the said section 37(5)(c) of the Ordinance has been omitted resulting in taxation of capital gain on immovable property under the Ordinance. Although in one of the petitions said tax on capital gain on immovable properties has also been challenged but the same is not being pressed at the moment.

10. After 18<sup>th</sup> Amendment all the powers to impose taxes on immovable properties have been devolved to the Provinces and such powers have been excluded from the domain of Entry 50 of the Federal Legislative List. A question arises that if all powers of taxes on immovable properties fall out of Federal domain then how such powers may be regained through legal fiction. If this principle is accepted, then any powers of the Provinces may be encroached upon by the Federation through legal fiction e.g. powers of the provinces to impose income tax on agriculture income or powers of the Provinces to impose sales tax on services. Thus we are of the considered view that all the powers to impose tax on immovable properties including the power to tax capital gain on immovable properties fall in the domain of the Provinces and not of the Federation. Thus the impugned provision of 7E is beyond the competence of the Federation as provided in the Federal Legislative List. Since it clearly falls in the legislative competence of the Provinces hence impugned provision of 7E is clear encroachment of the Federation on the legislative powers of the Provinces. Therefore, we are of the firm view that the impugned provision fails to pass the

first two tests being out of the competence of the Federal Legislative List and a clear encroachment on the powers of Provinces as provided in the Constitution.

It is important to note that after passing of 18<sup>th</sup> Amendment the four provinces framed their respective provincial laws in 2011, 2012, 2013 and 2015 for imposition of sales tax on services which powers were devolved to them through said amendment. Similarly, the Provinces of Sindh and Punjab framed



02/6

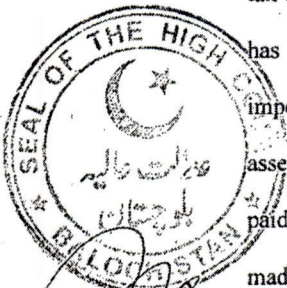
their respective laws for imposition of Capital Value Tax on Immovable Properties through Finance Acts 2010 and 2012 respectively. The other two provinces may also frame their respective laws. Thus imposition of income tax by the Federation on immovable properties would mean double taxation of same assets both by the Provinces and by the Federation.

12. Now coming to the rights of the citizens under Articles 23 and 24, the Constitution protects rights of citizens to acquire and hold property and the citizen cannot be compulsorily deprived of such property. Through impugned Section 7E income tax is imposed on immovable properties which do not generate income or which are not used in economic activity meaning that the citizen will ultimately be deprived of the immovable property. For paying taxes on immovable properties whereon no income is earned/ accrued the citizens will ultimately be forced to dispose of the immovable properties to pay said tax thereon. Hence section 7E being confiscatory in nature is clear violation of Articles 23 and 24 of the Constitution.

13. The impugned provision 7E also provides exceptions to some persons holding immovable properties e.g. owners of agricultural land, farm houses or those belonging to certain classes of persons and only those owners of immovable properties are liable to tax under section 7E on such properties who are not allowed said exemptions. Thus the impugned provision is discriminatory as well and a violation of Article 25 of the Constitution.

14. In the impugned provision of 7E the citizens are required to pay income tax on holding immovable properties earlier created through income on which tax has already been paid or source of investment thereof already explained. Thus imposing income tax on such properties would tantamount to double taxation of assets/ income of the citizen. Put simply the owner of immovable properties first paid tax on income from which said properties were purchased and then again made liable to pay tax on owning such immovable properties.

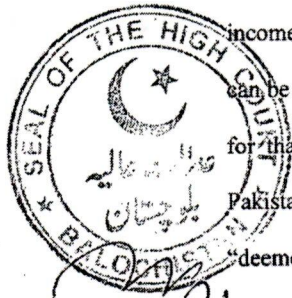
15. Regarding legal fiction of "deemed income" created by the impugned



provision 7E of the Ordinance we observe that a notional sum, not supported by any "economic transaction" is "treated to have been derived", as "income" chargeable to tax, being equal to five percent of the fair market value of capital assets situated in Pakistan. It means that no economic transaction is required to occur to attract impugned provision. The tax incidence arises without occurring of any "economic transaction". An economic transaction occurs when an economic value is provided by one economic unit to another; economic values are goods and services, and financial items. Buying and selling of goods is an economic transaction. Similarly paying school fees for the children is also an economic transaction. All economic transactions are not 'income generating economic transactions'. For example, school fee is not an income generating transaction for the payer. However, buying goods and services for business is an economic transaction which is an income generating economic transaction and that is what for which a question of deeming may arise.

16. In the impugned provision of 7E everything is notional and imaginary based on the ownership of an immovable property. In other words, to create a tax incidence a notional imagination has been related to ownership of an immovable property situated in Pakistan by a resident person. Under this novel provision, a sum being a percentage of fair market value of that immovable property, not being the cost of such property, without any economic transaction, is treated to have taken place as "income" chargeable under the Income Tax Ordinance, 2001.

17. The above legal fiction is partly created on the basis of Entry 47 of the Federal Legislative List and partly from the Supreme Court of Pakistan decision in the case of Elahi Cotton Mills Limited. Entry 47 of the Federal Legislative List empowers the Federation to impose taxes on income other than agricultural income. Income may include notional or deemed income. Taxation of "income" can be done under Entry 47, 48 and 52 of the Federal Legislative List and the law for that function is the Income Tax Ordinance, 2001. The Supreme Court of Pakistan in the case of Elahi Cotton Mills Limited has held that there can be a "deemed income". Furthermore, there are no limits as to what can be "deemed" to



05/6



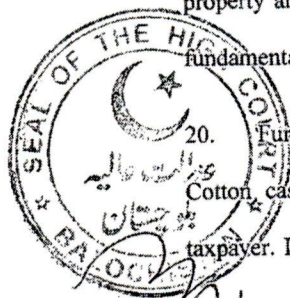
be the "income" as long as there are economic transactions resulting in such "deemed income". The concept of "deemed income" in the impugned provision also seems to be derived from the said judgment of the Apex Court in the case of Elahi Cotton Mills Limited.

18. Without prejudice to what Elahi Cotton Mills Limited's decision says regarding deemed income there is a fundamental difference between what has been taxed and held valid by the Supreme Court in Elahi Cotton Case and this tax under the impugned provision of 7E of the Ordinance. The Honorable Supreme Court in said decision has however placed certain bars on power of the legislature to treat an amount as "deemed income". In this regard we refer and reproduce clauses (xxii) and (xxiii) of Para 31 from judgment of the Apex Court in the case of Elahi Cotton Mills as under:

*(xxii) That any legislation whereby either the prices of marketable commodities are fixed in such a way as to bring them below the cost of production and thereby make it impossible for a citizen to carry on his business or tax is imposed to such a way so as to result in acquiring property of those on whom the incidence of taxation fell, then such legislation would be violative of the fundamental rights to carry on business and to hold property as guaranteed in the Constitution.*

*(xxiii) That the taxing power is unlimited as long as it does not amount to confiscation and that the Legislature does not have the power to tax to the point of confiscation.*

19. It is evident from above that while empowering the legislature to create legal fiction regarding deemed income the Apex Court has held that it should not be to the point of violating fundamental rights to carry on business and to hold property and it should not be to the point of confiscation. In both the cases the fundamental rights of the citizens will be violated.

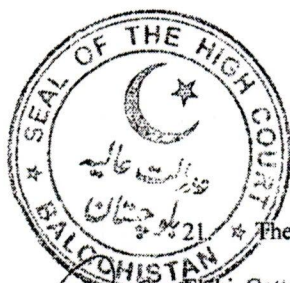


20. Further the amount which has been taxed as "deemed income" in the Elahi Cotton case was the result of an "Economic Transaction" undertaken by a taxpayer. In simple words, for example in the case of commercial imports it has

been stated that instead of taxing income being sales proceeds less cost of imports the amount of imports on which tax was collected at import stage is taken as "deemed income". All the subjects under appeal in the Elahi Cotton Mills were those where there was an "economic transaction" during the year for which a different manner of tax liability has been prescribed and the same has been taxed which has been treated as validly by the Supreme Court of Pakistan. We feel it necessary to refer and reproduce clauses (xxxii) and (xxxiii) of Para 31 from judgment of the Apex Court in the case of Elahi Cotton Mills as under:

*(xxxii) That the rule of interpretation that while interpreting an entry in a Legislative List it should be given widest possible meaning does not mean that Parliament can choose to tax as income as item which in no rational sense can be regarded as a citizen's income. The item taxed should rationally be capable of being considered as the income of a citizen.*

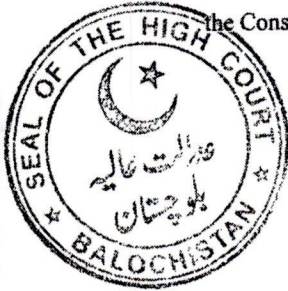
*(xxxiii) That before charging tax, an assessee must be shown to have received income or the same has arisen and accrued or deemed to be sounder the statute. Any amount which cannot be treated as above is not an income and cannot be subject to tax"*



0276 The above conclusion of the Honorable Supreme Court of Pakistan in Elahi Cotton case, though pertaining to of pre-Eighteenth Amendment period makes a very powerful finding and lays down the principle as to what extent an amount may be deemed and treated as income. Though deemed income may be given widest possible meaning but it does not mean that Parliament can choose to tax as income an item which in no rational sense can be regarded as a citizen's income. The item taxed should rationally be capable of being considered as the income of a citizen. Impugned Section 7E of the Ordinance by no rational sense can be called an income and be subjected to Income Tax. There is neither an economic transaction nor any accrual/ arising of an amount which may be deemed as income. In the case of impugned Section 7E there is no 'Economic Transaction' or event that can give rise to an amount that can be treated as

income. The deeming is based on mere ownership of immovable property with no economic transaction thereon. In the absence of any economic transaction, taxing immovable properties in the hands of owner through legal fiction of deeming is thus irrational even in the light of the Apex Court decision in the case of Elahi Cotton Mills.

For the reasons given above the instant petitions are allowed and the impugned provisions of Section 7E of the Ordinance are declared to be ultra vires the Constitution, hence it is struck down and is declared to be void ab initio.



SD/-Muhammad Hashim Khan Kakar  
Chief Justice  
SD/- Shoukat Ali Rakhshani  
JUDGE

Announced in open Court.  
Quetta the 30<sup>th</sup> May, 2024.

**SABIR HUSSAIN**  
Court Assistant  
Copying Section  
High Court of Balochistan  
Quetta.

05.06.2024.

05/6/2024