Form No: HCJD/C-121.
JUDGEMENT SHEET
IN THE ISLAMABADHIGH COURT, ISLAMABAD
JUDICIAL DE PARTMENT

INCOME TAX REFERENCE NO. 253 OF 2015

Commissioner Inland Revenue.

Vs

M/s Islamabad Electric Supply Company Limited, Islamabad (IESCO).

APPLICANT BY:	Mr. Saeed Ahmed Zaidi, Advocate.
RESPONDENTS BY:	Mr. Adnan Haider Randhawa, Advocate.
DATE OF DECISION:	19.01.2023

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BABAR SATTAR, J.- This reference filed under section 133 of the Income Tax Ordinance 2001 **("ITO")** emanates from the judgment of the learned Appellate Tribunal Inland Revenue **("Tribunal")** dated 13.03.2015, whereby the learned Tribunal accepted the appeal of the respondent on the basis that the demand created by the tax department (for the tax year 2007) was barred by time and dismissed the cross appeals filed by the tax department. The questions framed for our consideration are as follows:

i) *Whether the Appellate Tribunal Inland Revenue (Head Quarters), Islamabad was justified to hold the recovery order as time barred whereas the issue of time limitation had already been thrashed out by the Honorable Islamabad High Court, Islamabad in ITR 44-45 of 2007, dated 26/05/2009, and Honorable Supreme Court of Pakistan, vide Civil Appeals No. 1091-1092/2009, dated 17/05/2011, in which it was*

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clearly held that there is not time limitation involved in invoking section 52/86 of the repealed Ordinance, 1979, which is pari metria to section 161 of the Income Tax Ordinance, 2001?

ii) Whether the learned ATIR was justified in dismissing the department's appeal on the grounds of time limitation whereas no such time frame is envisaged u/s 161 of the Income Tax Ordinance, 2001.

iii) *Whether the learned Appellate Tribunal Inland Revenue (Head Quarters), Islamabad was justified to hold that the order is barred by time for 108 days in view of decision of Honorable Sind High Court, whereas the Honorable Islamabad High Court, Islamabad in ITR 44-45 of 2007 dated 26/05/2009 and Honorable Supreme Court of Pakistan in cases of 52/86 of the repealed ordinance read with section 161/205 of the Income Tax Ordinance, 2001, the limitation does not run because it is a matter of withholding taxes recovery and such order cannot be treated as assessment order?*

2. The learned counsel for the tax department submitted that the only question before the Court was whether the demand generated for the tax year 2007 was barred by limitation. He submitted that there was no limitation prescribed for purposes of notice issued under Section 161 of the ITO and it has been held by the learned Sind High Court in ***Habib Bank LTD vs. Federation of Pakistan through Secretary, Revenue Division and 5 others*** **(2013 PTD 1659)** that the tax department could issue notices under Section 161 of the ITO beyond the period prescribed for maintenance of tax record under Section 174 of the ITO, provided that the tax department provides sufficient

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justification for the same. He submitted that the said view was reiterated by the august Supreme Court in its decision dated 13.01.2021 in ***The Commissioner Inland Revenue, Zone-1, LTU vs. MCB Bank Limited*** **(2021 SCMR 1325)**. And consequently the learned Tribunal misapplied the law laid down in relation to the period within which a notice under Section 161 of the ITO could be issued and a demand generated against the Taxpayer.

3. The learned counsel for the respondent submitted that it was held in ***Habib Bank Ltd.*** that the obligation of a taxpayer to maintain tax record did not exceed the period prescribed under Section 174(3) of the ITO and no records could be solicited from a taxpayer for purposes of considering the creation of a demand after the prescribed period of five years (in relation to tax year 2007, which was subsequently changed by the amendment introduced through Finance Act, 2010 and is presently six years from the end of the relevant tax year). While a small window was left open within ***Habib Bank Ltd.*** for soliciting record after recording reasons for delay, it was held by the learned Lahore High Court in ***Maple Leaf Cement Factory Ltd vs. Federal Board of Revenue"*** **(2016 PTD 2074)** that any notice issued to a taxpayer under Sections 161 and 165 of the ITO read together with Rule 44 of the Income Tax Rules, 2002 (**"Rules"**) for purposes of production of record to consider whether or not tax demand was to be generated against the taxpayer was unlawful if such notice was issued after the expiry of the period prescribed for preservation of record under Section 174(3) of the ITO. And

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on the basis of such notices in the event that the taxpayer produced no record, no penal consequences could flow to the taxpayer. The law laid down in ***Maple Leaf Cement*** was endorsed and reiterated by the august Supreme Court in ***Commissioner Inland Revenue, Zone-IV, Lahore Vs. M/s Panther Sports & Rubber Industries (Pvt.) Ltd., etc.*** **(2022 SCMR 1135)**, which was the latest view of the august Supreme Court. He submitted that it was now settled that no demand could be generated against a taxpayer for his failure to produce any records that it was not required to retain beyond the statutory period of six years prescribed under Section 174(3) of the ITO (which period was five years for purposes of tax year 2007, in view of Section 174(3) as it then stood).

4. In the instant case a show cause notice was issued by the tax department to Islamabad Electric Supply Company Ltd. **("IESCO")** on 08.06.2013 to produce a reconciliation statement of its income and expenses as well as taxes withheld for the tax year 2007 within a period of seven days. IESCO failed to produce such record and an order generating a demand against IESCO was passed on 17.06.2013. IESCO filed an appeal against such order which was accepted by the learned Commissioner (Appeals) on 13.08.2013 and the Tax Department was directed to pass a reasoned order after examining the documents and details of payments made in relation to expenses during the tax year 2007. IESCO failed to produce records and documents for tax year 2007. The tax department then made an adverse presumption and

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generated a demand by order dated 28.02.2014 for IESCO's failure to discharge its obligations under Section 153 to withhold taxes while making payments. The Commissioner (Appeals) in order dated 17.04.2014 upheld the tax demand generated on the basis of adverse presumption made by the tax department upon failure of IESCO to produce the relevant record and reconciliation statement. And the learned Tribunal set aside such order and the demand generated in relation to tax year 2007 for being time-barred.

5. There is no disagreement between the parties that for purposes of tax year 2007, IESCO was under an obligation pursuant to section 174(3) of the ITO to maintain records for a period of five years after the end of the tax year to which they related. Admittedly, a show cause notice issued under Section 161 of the ITO read together with Section 205 of the ITO was issued almost one year after the expiry of the five-year period during which IESCO was under an obligation under Section 174(3) of the ITO to maintain tax records. As a factual matter it is also admitted that IESCO failed to produce records during the proceedings which led to the passing of the initial original order dated 08.06.2013 or during the proceedings that led to the passing of the subsequent order, after the matter was remanded, through which a tax demand was generated on 28.02.2014. The order dated 28.02.2014 notes that proceedings under Section 161 of the ITO read together with Section 205 of the ITO are a verification process and whether or not withholding tax has been collected and deposited within Treasury is to be determined on the basis of relevant record

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produced by the taxpayer. The original order states that demand was generated against IESCO for its failure to produce a record of the discharge of its withholding obligations under Section 153 and the tax department was consequently left with no option but to make an adverse inference that no tax had been deducted and deposited in the Treasury.

6. The question of the obligation of a taxpayer to produce record in proceedings where a show cause notice has been issued under Sections 161 and 162 of the ITO was considered by the learned Sindh High Court in ***Habib Bank Ltd.*** It was held that while considering the obligation of a taxpayer to produce record in proceedings under Sections 161 and 162 of the ITO, the obligation to maintain tax records under Section 174 of the ITO cannot be disregarded. And in the event that an action is taken by tax department under Section 161 of the ITO beyond the period prescribed under Section 174 of the ITO, the onus is on the tax department to justify such belated action. In ***Habib Bank Ltd***., in the absence of a reasonable justification, the learned Sindh High Court held that the department had failed to discharge the onus and the authority exercised under Section 161 of the ITO was therefore held to be unlawful. The law laid down in ***Habib Bank Ltd.*** was considered by the august Supreme Court in ***MCB Bank Limited,*** wherein it was noted that the judgment in ***Habib Bank Ltd.*** had been challenged before the august Supreme Court and the Revenue Authority had been allowed to issue fresh notices in respect of demand in question after giving reasons for initiating the process beyond the period prescribed

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for preserving tax record in terms of Section 174 of the ITO. After reproducing the order of the august Supreme Court dated 10.03.2020 in the appeal against the judgment in ***Habib Bank Ltd.,*** the apex Court held that the ratio of ***Habib Bank Ltd.*** appears to have been left intact and may even have been endorsed by the august Supreme Court. The Court, however, left the question of application of Section 174(2) to a demand generated under Section 161 of the ITR open to be decided in a suitable case in future.

7. The question of legality of demand generated pursuant to the proceedings initiated under Sections 161 or 165 of the ITO came before the learned Lahore High Court in ***Maple Leaf Cement.*** The learned Lahore High Court held that from *"a combined reading of subsections (1) and (3) of section 174 will ineluctably follow that while a taxpayer is obliged to maintain accounts and records for a period of five years, there is no obligation on the taxpayer to maintain such accounts beyond the period prescribed under subsection (3) of section 174. Had the intention of the legislature been that the records be maintained for all times to come or in eternity, there was no purpose to enacting subsection (3) of section 174."* The learned Lahore High Court observed that the logic behind such requirement was that the recovery *"proceedings must be initiated expeditiously and with all deliberate speed and preferably within the period mentioned in subsection (3) of section 174."*

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8. The same question subsequently arose before the august Supreme Court in ***M/s Panther Sports*** and was definitively settled. The rationale behind provisions of the ITO for prescribing that a taxpayer maintain tax records for a certain prescribed period was explained by the august Supreme Court by holding that *"time based obligation of maintaining records contemplated under the ordinance and the rules is a legislative mandate that promotes efficient and smart fiscal Administration and Governance."* In relation to the competence of the tax department to generate a demand against the taxpayer and the culmination of the proceedings initiated under Section 161 and 165 of the ITO read together with Rule 44(4) of the Rules, it was held that such demand would be unlawful in the event that the tax department initiated the process of soliciting tax records for purposes of Section 161 of the ITO after the period prescribed for maintenance of tax record under Section 174(3) of the ITO and the Rule 29 of the Rules. Let us reproduce what was held by the Supreme Court at some length:

> *"Section 174 creates an obligation on the taxpayer to maintain such accounts, documents and records as prescribed for a period of six years, except in case of pending proceedings, where the obligation of a taxpayer to maintain the record is till the final decision of the proceedings (exception is not attracted in the present case), while the same provision protects the taxpayer from being asked to produce the record beyond the said period. As notices under Sections 161, 165 and Rule 44(4) can only be replied to on the basis of the record maintained by the taxpayer, joint reading of Sections 161, 165 and Rule 44(4) and Section 174(3) and Rule 29*

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establishes that the tax department is under an obligation to be vigilant and efficient enough so as to proceed against a taxpayer within the statutory timeframe provided under section 174(3). Even though there is no specific limitation for issuance of notices under section 161(1A) or 165(2B) or Rule 44(4) but these provisions cannot be actualized or given effect to unless the record, available with the taxpayer, is examined and verified by the tax authorities. Since the aforesaid provisions of law require taxpayer to maintain record for a period of six years, hence notices beyond a period of six years cannot be given effect to. As the taxpayer is under no legal obligation to maintain tax records after the said statutory period, any such notices demanding the taxpayer to furnish such information are inconsistent with the clear provisions of the Ordinance and hence unlawful… We, therefore, endorse the view expressed in Maple Leaf by the Lahore High Court, where a similar question had come up before the court. We have also examined Habib Bank which holds that the department can override the timeframe under Section 174(3) by justifying the delay in initiating the matter against the taxpayer. Section 174(3) of the Ordinance read with Rule 29(4) of the Rules is clear and leaves no room for any such departmental justification, which in any case cannot deprive the taxpayer of the statutory protection under section 174(3) of the Ordinance. We, therefore, do not support the view expressed in Habib Bank as we have not been able to find any statutory support for the conclusion arrived at in the said case… Section 214A has no application to the present case and cannot be invoked to deprive the taxpayer of the statutory protection under section 174(3) of the Ordinance."

9. In view of the law laid down by the august Supreme Court in ***M/s Panther Sports*** the matter now rests. The learned counsel for tax department submitted that Section 174 spoke of the obligation of a taxpayer to maintain records and not of the withholding agent, who was under an obligation

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to withhold taxes on behalf of the Treasury under Section 153 of the ITO to maintain records. And this aspect of the matter had not been raised before the august Supreme Court in ***M/s Panther Sports***. The argument is without merit as the august Supreme Court in ***M/s Panther Sports*** endorsed the law laid down by the learned Lahore High Court in ***Maple Leaf Cement*** where the question before the Court related to the failure of the taxpayer to discharge his withholding obligations and thus proceedings had been initiated under Section 161 of the ITO. It was in that context that the learned Lahore High Court held that the taxpayer could not be required to present proof of discharge of his obligations as a withholding agent and provide a reconciliation statement for purposes of Rule 44(4) of the Rules after the period prescribed for maintenance of tax records under Section 174 of the ITO has already passed.

10. Even from a policy prospective it makes no sense that a collection agent, who has been endowed with a legal duty to withhold, collect and deposit taxes on behalf of the State, would be slapped with a duty more onerous than that imposed on the taxpayer itself under Section 174 of the ITO.

11. It is a matter of common sense that financial matters and financial obligations of taxpayers and businesses must be allowed to attain finality. Preserving records costs time, money and effort and the legislature in its wisdom has determined the period during which such obligation to maintain records subsists. Taxpayers, especially companies,

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design policies to destroy old records in view of legal obligations to maintain records under various statutes. The ITO is one such statute, which has prescribed that tax records are to be maintained for a certain period. The state can therefore not insist that taxpayers, as good Samaritans, must continue to retain tax records out of abundant caution as the State may emerge from its slumber and seek production of such records after the expiry of the period prescribed in law for purposes of maintaining tax records. Article 4(2)(C) of the Constitution provides that, "no person shall be compelled to do that which the law does not require him to do". Article 24 of the Constitution guarantees that no person shall be deprived of property in accordance with law. In the event that State generates a tax demand by making an adverse presumption against the taxpayer that he has not discharged his obligation to withhold tax on behalf of the State due to the failure of such taxpayer to produce tax records, even though the time period prescribed by law for preservation and maintenance of tax records has already passed, such demand could not be considered to be in accordance with law and may therefore qualify as being confiscatory in nature. Such adverse presumption by the tax department due to the failure of production of tax records after the prescribed period under Section 174 of the ITO would also fall foul of the guarantee under Article 10-A of the Constitution, which promises that civil rights and obligations are to be adjudicated fairly through due process.

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12. In view of the above, we find that any tax demand generated pursuant to proceedings initiated under Section 161 of the ITO on the basis of the taxpayer failed to produce tax record beyond the period prescribed for preservation of such records under Section 174 of the ITO is not backed by legal authority. We answer the questions raised for our consideration accordingly.

13. A copy of this order is directed to be sent to the Registrar of the learned Tribunal under the seal of this Court.

(MIANGUL HASSAN AURANGZEB)
JUDGE

(BABAR SATTAR)
JUDGE

Shakeel Afzal/-

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