Form No: HCJD/C-121.

JUDGEMENT SHEET

IN THE ISLAMABAD HIGH COURT, ISLAMABAD
JUDICIAL DEPARTMENT

Income Tax Reference No. 80 of 2007

The Attock Oil Company Limited

Vs.

Central Board of Revenue, Islamabad, etc.

APPLICANTS BY:	M/s Makhdoom Ali Khan, Saad M. Hashmi, Ali Sibtain Fazli, Rashid Anwar, Ali Mehdi, Hafiz Muhammad Idrees, Syed Farid Bukhari, Ms. Ayesha Hamid, M. Abdul Wali Irfan, Aziz ul Haq Nishtar, Abad ur Rehman and Umair Majeed Malik, Advocates. Mr. Muhammad Akif Khan, Deputy Chief Legal, PPL.
RESPONDENTS BY:	Mr. Saeed Ahmed Zaidi, Syed Ishfaq Hussain Naqvi, Dr. Farhat Zafar, Babar Bilal, Sheikh Anwar ul Haq and Ms. Shazia Bilal, Advocates.
DATES OF HEARING:	10.03.2022 and 17.03.2022.

BABAR SATTAR, J.- Through this judgment, we will adjudicate tax references listed in Annexure 'A' attached hereto. Even though the questions proposed for our consideration in the said references are more than one, the learned counsels for the applicants have stated that the only

question that requires to be answered in these references is as follows:

> *"Whether in calculating depletion allowance under Rule 3 of Part I of the Fifth Schedule to the Income Tax Ordinance, 1979, the amount of royalty is to be deducted from the well-head value?"*

3. Mr. Makhdoom Ali Khan, Senior ASC submitted on behalf of applicants that under section 26(b) of the Income Tax Ordinance, 1979, **("Ordinance")** a complete scheme has been provided for purposes of taxing the business of production of oil and natural gas, and exploration and extraction of other mineral deposits. That Section 26 is a non-obstante clause which excludes other provisions of the Ordinance and states that in relation to profits and gains from the exploration and production of petroleum and income of exploration and production companies from pipeline operations, and the manufacturing and sale of liquefied petroleum gas, tax is to be computed in accordance with the Rules contained under Part I of the Fifth Schedule to the Ordinance. That Rule 3 of Part-I of the Fifth Schedule to the Ordinance provides that 15% of the gross receipts that represent the wellhead value of the production of a petroleum exploration and production company is permissible as depletion allowance. He submitted that Rule 6(10) of Part-I of the Fifth Schedule defines "wellhead value" as that assigned to it in an agreement between a petroleum exploration and production company and the Government, and in the absence of a definition provided in such agreement, the meaning

assigned to "wellhead value" in Pakistan Petroleum (Exploration and Production) Rules, 1986 **("Petroleum Rules, 1986")**. He submitted that Petroleum Rules, 1986, defined the wellhead value as the market value of petroleum after excluding gathering, processing, treatment and transportation costs. He contended that the learned Income Tax Appellate Tribunal **("Tribunal")** had held that while calculating the depletion allowance under Rule 3 of Part-I of the Fifth Schedule to the Ordinance a royalty payable by the exploration and production companies to the Government would also be excluded from the wellhead value. He submitted that there was no room for reading in exclusion of royalty as a cost within the definition of wellhead value as provided under Rule 2(k) of the Petroleum Rules, 1986. He further submitted that in finding so the learned Tribunal had failed to appreciate that royalty payable by petroleum exploration and production companies is a cost the deduction of which from the wellhead value for purposes of calculation of depletion allowance was not provided for under the Petroleum Rules, 1986. He contended that in holding that depletion allowance is to be calculated by deducting royalty from gross receipts, the learned Tribunal was inspired by the treatment afforded to the calculation of depletion allowance by the Internal Revenue Service in the Unites States. But that the learned Tribunal did not appreciate that the relevant provision of the U.S Internal Revenue Code explicitly provided for the exclusion of rents and royalties incurred by a taxpayer in respect to the property in relation to which depletion was

being calculated. But that exclusion of rents and royalties was not provided for under Rule 3 of Part-I of the Fifth Schedule to the Ordinance read together with Rules 2(e), 2(k) and 38 of the Petroleum Rules, 1986.

4. Learned counsels for other applicants adopted the arguments made by Mr. Makhdoom Ali Khan, Senior ASC.

5. Mr. Saeed Ahmed Zaidi, Advocate, submitted on behalf of the Commissioner Inland Revenue that Rule 3 of Part I of the Fifth Schedule to the Ordinance made an allowance for depletion equal to 15% of the gross receipts representing wellhead value of the production. He submitted that under Rule 36 of the Petroleum Rules, 1986, the petroleum exploration and production companies were under an obligation to pay a royalty at the rate of 12.5% of the wellhead value of the petroleum produced. He submitted that Rule 37 of the petroleum Rules, 1986, provided that the Government could decide in its discretion whether royalty was to be paid in kind. And that when provisions of Rules 36 and 37 were read together with Rule 38, pursuant to which value of petroleum for purposes of royalty was to be calculated, it was evident that the interest of the petroleum exploration and production companies in the wellhead value excluded 12.5% royalty of the value of petroleum payable by such companies to the Government. His contention was that as the Government had a right to royalty in the amount of 12.5% of the value of petroleum derived from the wellhead, calculating depletion allowance for purposes of Rule 3 of Part-I of the

Fifth Schedule to the Ordinance would amount to enabling petroleum exploration and production companies to engage in double-dipping. That, in other words, such treatment of the depletion allowance would allow petroleum exploration and production companies an allowance against a right which accrued to the Government and not to such companies. Given that in view of Rule 36 of the Petroleum Rules, 1986, the interest of the Federal Government in the form of royalty was defined, the petroleum exploration and production companies were not entitled to claim depletion against such interest. Mr. Zaidi, supported the decision of the learned Tribunal wherein it had been held for purposes of calculation of depletion allowance that royalty was to be deducted from the wellhead value.

6. Let us first reproduce the relevant provisions (i.e. section 26(b), Rule 3 and Rule 6(10) of Part I of the Fifth Schedule) of the Income Tax Ordinance, 1979, that are applicable in the present case.

> ***26. Special provisions regarding business of insurance and production of oil and natural gas and exploration and extraction of other mineral deposits etc.****- Notwithstanding anything contained in this Ordinance,-*
>
> *(b) the profits and gains from the exploration and production of petroleum (including natural gas) and from refineries to be set up at Dhodak and Bobi fields; income from exploration and production companies from pipeline operations, and manufacture and sale of liquefied gas or compressed natural gas and the tax payable thereon shall be computed in accordance with the rules contained in Part I of the Fifth Schedule;*

> ***3. Depletion allowance**.- In determining the income of such undertaking for any year ending after the date on which commercial production has commenced, an allowance for depletion shall be made equal to fifteen per cent of the gross receipts representing the well-head value of the production:*
> *Provided that such allowance shall not exceed fifty per cent of the profits or gains of such undertaking before the deduction of such allowance.*

> ***6(10)."well-head value"** has the meaning assigned to it in the agreement between the assessee and the Government and, in the absence of any such definition in the agreement, the meaning assigned to it in the Pakistan Petroleum (Production) Rules, 1949 or the Pakistan Petroleum (Exploration and Production) Rules, 1986.*

7. It is an admitted fact that for purposes of determination of wellhead value, the concession agreements between the Government and petroleum exploration and production companies do not include any definition of wellhead value and consequently the definition of wellhead provided in Petroleum Rules, 1986, is to be relied upon.

8. Let us also reproduce the relevant provisions of the Petroleum Rules, 1986, that are relevant for our present purposes.

> ***2(e). "Market value"** means the value of the Petroleum as determined pursuant to rule 38.*
>
> ***2(k). "Wellhead value"** means the market value of the Petroleum less gathering, processing, treatment and transportation costs from the wellhead to the place at which the market value is determined, and in the case of natural gas shall also include compression, dehydration and liquefaction costs.*

36. Royalty.-

(1) Subject to the payment of such additional amount by way of royalty as may be specified in any agreement with the Government to which the holder of the lease is a party, the holder shall pay a royalty at the rate of 12.5 per cent of the wellhead value of the Petroleum produced and saved.

(2) Royalty is payable monthly within 10 days of the expiry of the calendar month in question.

(3) From the amount of royalties payable in respect of any one year of the term of a lease, there shall be deducted the amount of yearly lease rent actually paid in respect of that year pursuant to rule 39.

37 Royalty in kind.-

(1) The Government may, with six months' notice, decide according to rule 36 shall, wholly or partly, be satisfied in kind. In such case the holder shall at the request and at the cost of the Government arrange for transportation, treatment, storage of the royalty Petroleum and such other activities related thereof as the Government may reasonably require, in the same manner as if it were his own Petroleum.

(2) The Government shall lift or take royalty Petroleum in a timely manner and in accordance with such lifting or sales agreement as may have been agreed.

38. Value of Petroleum.-

For the purpose of calculating the amount due by way of royalty, the value of Petroleum shall be:

(a) in the case of Petroleum delivered to the national market pursuant to rule 41 the price actually realized in such sales;

(b) in the case of Petroleum not sold pursuant to rule 41 the international market price determined in such manner as the Government, subject to the terms and conditions of any agreement between the PRESIDENT and the lessee, may, from time to time, determine.

9. A perusal of the scheme for taxation of the business of petroleum exploration and production under section 26(b) of the Ordinance reflects that for purposes of determination of depletion allowance under Rule 3 read together with Rule 6(10) of Part I of the Fifth Schedule to the Ordinance, the definition of wellhead value provided under the Petroleum Rules, 1986, has been incorporated by reference. The definition of wellhead value under Rule 2(k) of the Petroleum Rules, 1986, plainly provides that wellhead value is the value derived after excluding the costs of gathering, processing, treatment and transportation of petroleum from the market value of petroleum. Market value as defined under clause 2(e) is the value determined pursuant to Rule 38 of the Petroleum Rules, 1986. Rule 38 then states the manner in which the market value is to be calculated for purposes of calculating the amount due by way of royalty and in case of petroleum delivered to national market, it is the price actually realized by the sale of petroleum.

10. What emerges from the scheme is that for purposes of calculation of wellhead value, Rule 2(k) incorporates, by reference, the market value of petroleum as determined for purposes of calculation of royalty under Rule 38 of the Petroleum Rules, 1986. Merely because the definition of wellhead value incorporates by reference the mechanism for calculation of market value that is employed for purposes of calculation of royalty under Rule 38, does not automatically incorporate within the definition of wellhead value the

quantum of royalty payable to the Government as a cost that is to be excluded from market value for purposes of determination of wellhead value. Rule 36 provides that a certain part of market value of petroleum as determined pursuant to Rule 38 is to be paid by the petroleum exploration and production company to the Government as royalty. Rule 2(K) provides that after excluding the cost of gathering, processing, treatment and transportation from the market value of petroleum what remains is the wellhead value, which value is then used by Rule 3 of Part I of the Fifth Schedule to the Ordinance to calculate the depletion allowance admissible to a petroleum exploration and production company.

11. What the learned Tribunal has done and the learned counsel for the Commissioner Income Tax wishes for us to do, is to read within the definition of wellhead value provided under 2(k) of the Petroleum Rules, 1986, the exclusion of royalty payable by the petroleum exploration and production company to the Government from the market value of petroleum in addition to the cost of gathering, processing, treatment and transportation of petroleum, to quantify the wellhead value. As the definition of the wellhead value provided under Rule 2(k) of the Petroleum Rules, 1986, has been incorporated by reference in Rule 3 of Part I of the Fifth Schedule to the Ordinance read with section 26(b) of the Ordinance, reading into the definition of wellhead value would

fall foul of the doctrine of [1]*casus omissus* which would be against settled principles of interpretation of taxation laws.

11. The learned Tribunal instead of interpreting the definition of wellhead value in accordance with its plain meaning and the words used in Rule 2(k) of the Petroleum Rules, 1986, appears to have opted for an equitable interpretation of Rule 3 of Part I of the Fifth Schedule to the Ordinance in holding that while calculating depletion allowance the amount of royalty payable by petroleum exploration and production companies to the Government is to be deducted from the wellhead value. The learned Tribunal has inferred that it would be unfair to allow petroleum exploration and production companies the benefit of not deducting the amount of royalty due to the Government from the market value of petroleum. It has done so by treating the royalty payable by petroleum exploration and production companies as an equity interest of the Government in the value of the remaining product which is to be measured under the definition of the wellhead value. In coming to such conclusion, it has relied on the definition of depletion as used in the Internal Revenue Code of the United States which explicitly excludes from the gross income of the property whose depletion is being calculated an amount equal to any rents or royalties incurred by a taxpayer in respect of such property. In interpreting Rule 3 of Part I of the Fifth Schedule

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[1]*See Amanullah Khan Vs. Chief Secretary, Govt. of N.W.F.P (1995 SCMR 1856); Nadeem Ahmed Advocate Vs. Fed. of Pakistan (2013 SCMR 1062) and Gul Taiz Khan Marwat Vs. Registrar, Peshawar High Court (PLD 2021 SC 391).*

to the Ordinance, the learned Tribunal in our opinion has not appreciated the following:

1. The manner in which the depletion allowance is to be calculated under the U.S Internal Revenue Code is different from the manner in which the depletion allowance is to be calculated for purposes of Rule 26(b) of the Ordinance, as the U.S Code explicitly provides for exclusion of any rents or royalties from the income of the property against which allowance for depletion is being calculated.

2. Rule 3 of Part I of the Fifth Schedule read together with Rule 6(10) of the Ordinance when read in juxtaposition with Rules 2(e), 2(k) and 38 of the Petroleum Rules, 1986, does not make any provision for exclusion of royalty from the market value of petroleum. The practice of the U.S. Internal Revenue Service that the learned Tribunal has relied on is the consequence of a different statutory provision. The same treatment cannot be meted out to calculation of the depletion allowance under the Ordinance as exclusion of rents or royalties from the market value of petroleum for proposes of calculation of the depletion allowance is not provided for under Rule 3 of Part I of the Fifth Schedule to the Ordinance read with relevant provisions of the Petroleum Rules, 1986, incorporated by reference.

3. There is nothing preventing the legislature from providing within the Ordinance that depletion allowance would be calculated on the basis of wellhead value, which in turn would be calculated on the basis of market value of petroleum by excluding from such value any amount payable to

the Government as royalty. The legislature has not done so and it is not for the learned Tribunal or for this Court to determine what would be a preferable policy for calculation of depletion allowance or otherwise incentivizing petroleum exploration and production companies. In reading into the definition of the wellhead value under section 2(k) of the Petroleum Rules, 1986, as incorporated by Rule 6(10) and Rule 3 of Part I of the Fifth Schedule to the Ordinance, the learned Tribunal seems to have disregarded the following dicta from ***Cape Brandy Syndicate v. Inland Revenue Commissioner (1921) 1 K.B. 64)***, on which is founded our own settled principles of statutory interpretation of [2]fiscal statutes, in which Rowlatt J. famously said:

> *"… in a taxing Act one has to look merely at what is clearly said. There is no room for any intendment. There is no equity about a tax. There is no presumption as to a tax. Nothing is to be read in, nothing is to be implied. One can only look fairly at the language used*."

4. A plain reading of Rule 2(k) of the Petroleum Rules, 1986, reflects that wellhead value means the market value of petroleum as calculated for purposes of Rule 38 of the Petroleum Rules, 1986, after excluding the gathering, processing, treatment and transportation costs of such petroleum. The definition of wellhead value as incorporated by reference in Rule 6(10) of Part I of the Fifth Schedule to the Ordinance does not allow reading into such definition exclusion of royalty payable by petroleum exploration and production companies to the Government for purposes of

[2] See *Collector of Customs Vs. Muhammad Mahfooz (PLD 1991 SC 630), Star Textile Mills Ltd. Vs. Govt. of Sindh* (2002 SCMR 356*) and Province of the Punjab v. Muhammad Aslam (2004 SCMR 1649).*

calculation of depletion allowance under Rule 3 of Part I of the Fifth Schedule to the Ordinance.

12. In view of the above, we answer the question proposed for our consideration by holding that for purposes of calculating depletion allowance under Rule 3 of Part I of the Fifth Schedule to the Ordinance, the amount of royalty paid by a taxpayer to the Government is not to be deducted while computing the wellhead value.

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

(CHIEF JUSTICE) (BABAR SATTAR)
JUDGE

Announced in the open Court on _____/2022.

(CHIEF JUSTICE) JUDGE

Saeed.

ANNEXURE-A		
1.	I.T.R No. 80/2007	Attock Oil Company Limited. Vs. Central Board of Revenue, etc.
2.	I.T.R No. 62/2007	Attock Oil Company Limited Vs. Central Board of Revenue, etc.
3.	I.T.R No. 63/2007	The Attock Oil Company Limited Vs. Central Board of Revenue, Islamabad and others.
4.	I.T.R No. 81/2007	Attock Oil Co. Ltd. Vs. CBR, etc.
5.	T.R No. 01/2008	M/s Government Holdings (Pvt.) Ltd. Vs. Additional Commissioner (Audit), etc.
6.	T.R No. 02/2008	M/s Government Holdings (Pvt.) Ltd. Vs. Additional Commissioner (Audit), etc.
7.	T.R No. 06/2008	M/s Mari Gas Company Ltd. Vs. Deputy Commissioner of Income Tax
8.	T.R No. 07/2008	M/s Mari Gas Company Ltd. Vs. Deputy Commissioner of Income Tax
9.	T.R No. 15/2008	M/s Mari Gas Company Ltd. Vs. Deputy Commissioner of Income Tax
10.	I.T.R No. 39/2009	Pirkoh Gas Co. Pvt. Ltd Vs. Deputy Commissioner of Income Tax
11.	I.T.R No. 40/2009	Pirkoh Gas Co. Pvt. Ltd Vs. Deputy Commissioner of Income Tax
12.	T.R No. 41/2009	M/s Mari Gas Company Ltd. Vs. Commissioner of Income Tax
13.	T.R No. 42/2009	M/s Mari Gas Company Ltd. Vs. Commissioner of Income Tax
14.	I.T.R No. 272/2011	M/s MND Exploration and Production Ltd. Vs. Appellate Tribunal Inland Revenue and others.
15.	I.T.R No. 273/2011	M/s MND Exploration and Production Ltd. Vs. Appellate Tribunal Inland Revenue and others.
16.	I.T.R No. 274/2011	M/s MND Exploration and Production Ltd. Vs. Appellate Tribunal Inland Revenue and others.
17.	I.T.R No. 275/2011	M/s MND Exploration and Production Ltd. Vs. Appellate Tribunal Inland Revenue and others.
18.	I.T.R No. 276/2011	OMV Pakistan Exploration Vs. Commissioner Inland Revenue.
19.	I.T.R No. 277/2011	OMV Pakistan Exploration Vs. Commissioner Inland Revenue.

20.	I.T.R No. 01/2012	BHP Exploration Pakistan Vs. Commissioner Inland Revenue.
21.	I.T.R No. 02/2012	BHP Petroleum Pakistan Vs. Commissioner Inland Revenue.
22.	I.T.R No. 03/2012	BHP Petroleum Pakistan Vs. Commissioner Inland Revenue.
23.	I.T.R No. 04/2012	BHP Petroleum Pakistan Vs. Commissioner Inland Revenue.
24.	I.T.R No. 39/2012	M/s MND Exploration and Production Ltd. Vs. Appellate Tribunal Inland Revenue and others.
25.	I.T.R No. 40/2012	M/s MND Exploration and Production Ltd. Vs. Appellate Tribunal Inland Revenue and others.
26.	I.T.R No. 41/2012	M/s MND Exploration and Production Ltd. Vs. Appellate Tribunal Inland Revenue and others.
27.	I.T.R No. 134/2014	M/s PPL Europe E&P Limited Vs. Commissioner Inland Revenue, etc.
28.	I.T.R No. 135/2014	M/s PPL Europe E&P Limited Vs. Commissioner Inland Revenue, etc.
29.	I.T.R No. 46/2017	Orient Petroleum Pty. Limited Vs. Commissioner Inland Revenue, etc.
30.	I.T.R No. 56/2018	M/s Government Holdings (Pvt.) Limited Vs. Additional Commissioner (Audit-II), etc.
31.	I.T.R No. 57/2018	M/s Government Holdings (Pvt.) Limited Vs. Additional Commissioner (Audit-II), etc.
32.	I.T.R No. 58/2018	M/s Government Holdings (Pvt.) Limited Vs. Additional Commissioner (Audit-II), etc.
33.	I.T.R No. 13/2019	M/s Pakistan Oilfields Limited Vs. Appellate Tribunal Inland Revenue Bench, Islamabad etc.
34.	I.T.R No. 42/2020	Orient Petroleum Pty. Limited Vs. Additional Commissioner Inland Revenue, etc.
35.	I.T.R No. 11/2022	MOL Pakistan Oil and Gas Co. B.V Vs. Commissioner Inland Revenue, LTU (Zone-III).