JUDGMENT SHEET

IN THE LAHORE HIGH COURT, LAHORE
JUDICIAL DEPARTMENT

ITR No.73049 of 2022

Commissioner Inland Revenue

Versus

M/s Gujranwala Electric Power Co. (GEPCO)

J U D G M E N T

Date of Hearing.	06-12-2023
APPLICANT BY:	M/s Riaz Begum, Shahzad Ahmad Cheema Malik Abdullah Raza, Falak Sher Khan, Shahid Sarwar Chahil, Liaqat Ali Chaudhry, Syed Zain ul Abideen Bokhari and Waqar A. Sheikh Advocates.
RESPONDENTS BY:	M/s Malik Kashif Rafiq Rajwana, Malik Asif Rajwana, Ehtisham ud Din Khan, Malik Rizwan Khalid, Muhammad Umer Rafiq, Muhammad Adeel Chaudhry, Rana Tahir Mahmood, Abdul Latif, Qari Zuhaib ur Rehman Zubairi, Muhammad Afzal Dharala, Advocates for respondents/ for applicants in ITR Nos.74710 and 74708 of 2017, ITR Nos.59530,76238 and 76250 of 2023. Malik Muhammad Arshad Hameed, Advocate for respondent in ITR No.82911 of 2017. M/s Main Ashiq Hussain, Muhammad Arshad, Waqas Ahmad Aziz, Shehzad Ahmad and Mian Muhammad Naeem Wattoo, Advocates for respondents/for applicants in ITR Nos.14774 and 14763 of 2023. M/s Samar Masood Soofi, Shamsher Ali, Arslan Saleem and Rana Muhammad Mehtab, Advocates for respondents in CIR reference applications. Mr. Asad Ali Bajwa, D.A.G.

Shahid Karim, J:-. This is a reference application under Section 133 of the Income Tax Ordinance, 2001 (**"the Ordinance"**) and brings a challenge to the order dated 12.05.2022 passed by the Appellate Tribunal Inland Revenue. The following questions of law have been

framed for the opinion of this Court and which are crucial for the decision of the controversy involved:

1. *Whether on the facts and in the circumstances of the case, the learned Tribunal has not misinterpreted the subsidy granted by the Federal Government for taxpayer's consumer not effecting the supply/ sales of taxpayer required to be added in the turnover u/s 113 of the Income Tax Ordinance, 2001?*
2. *Whether in the facts and circumstances of the case, the learned Tribunal was justified to hold that the subsidy cannot be added as turnover for the purposes of charging of tax u/s 113 of the Income Tax Ordinance, 2001?*
3. *Whether on the facts and in the circumstances of the case the learned Tribunal has not misinterpreted the subsidy in question which is exempt from levy of tax under clause 102-A of the Part I of the 2nd Schedule to the Income Tax Ordinance, 2001 but cannot be excluded from the turnover under Section 113 of the Income Tax Ordinance, 2001?"*

2. This judgment will also decide connected reference applications ITR Nos.146 of 2016, 196 of 2016, 41 of 2017, 82911 of 2017, 82915 of 2017, 82919 of 2017, 42 of 2017, 75743 of 2021, 75744 of 2021, 75745 of 2021, 75746 of 2021,75747 of 2021, 75748 of 2021 and 75749 of 2021, ITR Nos.74708 of 2017, 74710 of 2017, 14763 of 2023, 14774 of 2023, 59530 of 2023, 76238 of 2023, 76250 of 2023. Some of the tax references have been filed by the department while others have been filed by the distribution companies (Discos). This was necessitated because Benches of the Tribunal have rendered conflicting judgments on the same issue of law.

3. It is common ground between the parties that the respondents/taxpayers are public limited companies engaged in the business of distribution of electricity (Discos). Deeming assessment under Section 120 of the

Ordinance was found erroneous in so far as prejudicial to the interest of revenue and hence an order under Section 122(5A) of the Ordinance was passed charging minimum tax under Section 113 of the Ordinance. This was done by inclusion of subsidy granted by the Federal Government in other income as part of the turnover of the Discos thereby making an apportionment under Section 67 of the Ordinance. The Discos contended before the Assessing Officer that Tariff Differential Subsidy (**TDS**) was a relief provided by Federal Government to different categories of consumers of electricity by notifying reduced rates of electricity. It is undisputed that TDS is contributed by Federal Government and on that account reduced tariff is notified for certain consumers to provide financial support and in fact no actual sale is made by the Discos to the Government. With the exclusion of TDS from sales, Discos contend that they are incurring gross losses and therefore subsidy cannot be made a charge of minimum tax. In sum, Discos submit that minimum tax under Section 113 of the Ordinance is chargeable on the amount billed and received from the consumers of electricity while the amount received as subsidy provided by the Federal Government to distribution companies was not chargeable to minimum tax.

4. The controversy turns on the true construction of the term ‘turnover’ as defined in section 113 (3) of the Ordinance which provides that:

"113. Minimum tax on the income of certain persons.- (1) This section shall apply to a resident company, permanent establishment of a non-resident company, an individual (having turnover of hundred million rupees or above in the tax year 2017 or in any subsequent tax year) and an association of persons (having turnover of hundred million rupees or above in the tax year 2017 or in any subsequent tax year) where, for any reason whatsoever allowed under this Ordinance, including any other law for the time being in force —

(a) loss for the year;

(b) the setting off of a loss of an earlier year;

(c) exemption from tax;

(d) the application of credits or rebates; or

(e) the claiming of allowances or deductions (including depreciation and amortization deductions) no tax is payable or paid by the person for a tax year or the tax payable or paid by the person for a tax year is less than the percentage as specified in column (3) of the Table in Division IX of Part-I of the First Schedule of the amount representing the person's turnover from all sources for that year:

(2) Where this section applies:

(a) the aggregate of the person's turnover as defined in sub-section (3) for the tax year shall be treated as the income of the person for the year chargeable to tax.

(b) the person shall pay as income tax for the tax year (instead of the actual tax payable under this Ordinance), minimum tax computed on the basis of rates as specified in Division IX of Part I of First Schedule;

(c) where tax paid under sub-section (1) exceeds the actual tax payable under Part I, clause (1) of Division I, or Division II of the First Schedule, the excess amount of tax paid shall be carried forward for adjustment against tax liability under the aforesaid Part of the subsequent tax year:

Provided that if tax is paid under sub-section (1) due to the fact that no tax is payable or paid for the year, the entire amount of tax paid under sub-section (1) shall be carried forward for adjustment in the manner stated aforesaid:

Provided further that the amount under this clause shall be carried forward and adjusted against tax liability for three tax years immediately succeeding the tax year for which the amount was paid.

(3) "turnover" means,-

(a) the gross sales or gross receipts, exclusive of Sales Tax and Federal Excise duty or any trade

> ***discounts shown on invoices, or bills, derived from the sale of goods, and also excluding any amount taken as deemed income and is assessed as final discharge of the tax liability for which tax is already paid or payable;***
>
> *(b) the gross fees for the rendering of services for giving benefits including commissions; except covered by final discharge of tax liability for which tax is separately paid or payable;*
>
> *(c) the gross receipts from the execution of contracts; except covered by final discharge of tax liability for which tax is separately paid or payable; and*
>
> *(d) the company's share of the amounts stated above of any association of persons of which the company is a member."*

5. Section 113 of the Ordinance is a regime of taxation based on minimum tax on the income of certain persons. It is triggered under circumstances mentioned in section 113 and applies to a resident company, permanent establishment of a non-resident company, an individual having turnover of 300 Million rupees or above in the tax year etc. The parties do not quarrel that Discos which are before this Court in the present cases are being charged minimum tax on their incomes. Sub-section (2) provides the formulae for classification of the income of a person who is caught by the provisions of section 113. It states that the aggregate of the person's turnover as defined in Sub-section (3) for the tax year shall be treated as the income of the person for the year chargeable to tax.

6. We now turn to the definition of the term 'turnover' which has been set out above. Clause (a) of Sub-section (3) is the relevant clause for our purposes in order to arrive at a just decision in the present cases.

According to that definition turnover means the **gross sales or gross receipts** exclusive of sales tax and federal excise duty or any trade discounts shown on invoices or bills **derived from the sale of goods** and also excluding any amount taken as deemed income. The case of Discos is that it is crucial for the determination of turnover that there should be **gross receipts derived from the sale of goods**. It ineluctably follows that there has to be sale of goods from which the gross receipts are derived and unless it is shown that there has been an actual sales of goods, no income can be included in the term 'turnover' as defined in section 113 (3)(a) of the Ordinance.

7. In order to determine the real controversy, the backcloth of the transaction has to be analysed in its proper perspective. The determination of tariff of electricity is made by National Electric Power Regulatory Authority (**NEPRA**) which does so by its decision in the official gazette. The decision which forms the background of the present cases was made by NEPRA on 27.05.2022 pursuant to Sub-section (7) of Section 31 of the Regulations of Generation, Transmission and Distribution of Electric Power Act, 1997 (**"the 1997 Act"**). NEPRA modified the decision of the Authority in the matter of Motion filed by the Federal Government under Sections 7 and 31 of the 1997 Act read with rule 17 of the NEPRA (Tariff, Standards and Procedure) Rules, 1998 with respect to

recommendations of the consumer-end-tariff for Discos and K-Electric. That decision gives a background of determination of tariffs for Discos for the financial year 2018-19 and financial year 2019-20 individually under the single year tariff regime for both their distribution and supply functions separately. The tariff determinations/ decisions were forwarded to the Federal Government for notification under Section 31(7) of the 1997 Act. In response, the Federal Government in its letter dated 21.01.2021 submitted a Motion for recommendation of consumer-end-tariff for the Discos which was decided by the Authority vide decision dated 12.02.2021. Subsequently, the Federal Government vide letter dated 15.10.2021 submitted another Motion with respect to recommendations of consumer-end-tariff for the Discos and the underlying intention for doing so was encapsulated in the Motion in the following terms:

> *i. Economic Co-Ordination Committee (ECC), vide its decision dated October 24, 2018 approved the Methodology for arriving at Uniform Tariff and its Adjustment, which was, thereafter, approved and ratified by the Cabinet. Furthermore, to structure the discretion for arriving at such uniform tariff, further appropriate guidelines were also adopted, which be read as an integral part of this request.*
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> *v. Based on the consolidated revenue requirements of DISCOs as well as the economic and financial policy of the Federal Government, the tariff differential subsidy (TDS) is proposed to be modified and reduced. This modification in the targeted subsidy is proposed to be given effect along-with modification of inter disco tariff rationalization/cross subsidies per practice in vogue, through modification of the applicable variable charge of categories of consumers of XWDISCOs. The same has been approved by the Federal Government and is*

submitted to the Authority for consideration in terms of section 31(4) of the Act. This modification is not aimed at raising any revenues for the Federal Government, as it is within the determined revenue requirements of the SWDISCOs, as consolidated and determined by the Authority in the terms of section 31(4) of the Act.

vii. In light of the above, the instant Motion has been filed by the Federal Government with respect to Consumer End Tariff Recommendations under section 7, 31(4) and 31(7) of the Act read with Rule 17 of the NEPRA Tariff (Standards and Procedures) Rules, 1998 so as to reconsider and issue the revised/modified uniform schedule of tariff of XWDISCOs, by incorporating revised subsidy and inter distribution companies tariff rationalization/cross subsidies for the category of each of NEPRA determined notified rate (inclusive of subsidy/cross subsidies/inter disco tariff rationalization) in SRO Nos.01 to 10 of 2019 dated January 01, 2019 as modified by SROs 182 to 191(I)/2021 dated February 12, 2021 and 1280 to 1289(I)/2021 dated October 01, 2021."

8. The Motion was triggered by the decision of the Economic Coordination Committee (ECC) dated October 24, 2018 which approved the modification for arriving at uniformity of tariff and its adjustment. Consequently, after accounting for tariff rationalization, tariff differential subsidy and cross subsidies, such amendments/ modification were to result in net required subsidy to the tune of Rs.240 Billion to various categories of consumers. Based on the consolidated revenue requirements of Discos, TDC was proposed to be modified and reduced. It is necessary to bear in mind that the modification was not aimed at raising any revenue for the Federal Government as it was within the determined revenue requirements of the Discos as consolidated and determined by the Authority.

9. The decision clearly envisaged the intention of the Government to allow targeted subsidies and recover the cost of electricity. Upon examination of the pleadings made in the Motion and the available record with the Authority, determination and order was made in the matter. In conclusion, the following decision was made by approving the revised applicable tariff as proposed by the Federal Government (**the Decision**):

> *"23. The Authority also understands that the proposed tariff by the Federal Government is also within the overall revenue requirement of DISCOs as determined by the Authority.*
>
> *24. In view of the discussion made in the preceding paragraphs, the Authority has indicated the revised applicable tariff as proposed by the Federal Government, which is attached herewith as **Annex-A, B and C**. The same shall replace the already issued Annex A, B and C, attached with the decision of the Authority dated 23.09.2021 in the matter of Policy Guidelines by the MoE for providing basis for retargeting of power sector subsidies. In addition, an Annex-D i.e. SoT without incorporating the impact of PYA has been attached, which shall become applicable w.e.f. 12.02.2022."*

10. It is clear that the Motion of the Federal Government as approved by the Authority gave rise to a structure whereby the Federal Government subsidized the rate of electricity tariff in respect of certain categories of consumers. According to that arrangement, the consumers were billed at a certain rate by the Discos whereas the rest of the amount was to be reimbursed by the Federal Government in the accounts of the Discos. It must be emphasized and this has also been noted in the decision of the Authority that the

ultimate goal of the Government to allow targeted subsidies was to recover the cost of electricity as also that the modification for the targeted subsidy and the consequent modification and rationalization of tariff determination was within the determined revenue requirements of the Discos. The decision of the Authority merely incorporated the revised subsidy proposed by the Government and proceeded to effect inter-Disco tariff rationalization/ cross subsidies for the category of each NEPRA determined modified rate (inclusive of subsidy/ gross subsidies/ inter Disco tariff rationalization). We have no reason to believe that Discos were burdened with modified rates of tariff which were to be recovered from the consumers. The revised / modified uniform schedule of tariff determined by NEPRA merely factored in the subsidy/ cross subsidy which was to be restituted by the Federal Government in favour of Discos. Thus, Discos charged certain portion of the tariff from the consumers whereas the other portion of the tariff as determined by NEPRA was reimbursed by the Federal Government into the accounts of Discos. At the end of it, Discos did not suffer a diminution of their income which was made up of two different streams.

11. The learned counsel for Discos emphasized during the oral arguments that gross receipts have to be derived from the sale of goods whereas in the case of the portion which is reimbursed by the Federal Government,

there is no sale of goods. This is an erroneous view and is based on a misconstruction of the entire transaction brought forth above. Doubtless, the Federal Government is a necessary party to the entire architecture under which tariff determination is made by the Authority and it is on the Motion of the Federal Government that subsidy is given to the consumers. On that basis, there is indeed a sale of goods in favour of the consumers. The only difference is that the moneys recovered in respect of sale of goods come from two different sources in the present cases. Since the transaction is unique, this Court will have to view the term 'sale of goods' in the peculiar context and setting of the entire transaction which has been set out above. To reiterate, subsidy is not given by the Federal Government in favour of the Discos but is handed out to the consumers. Secondly, there is indeed sale of goods which takes place and Discos accumulate gross receipts as well which as stated above comprise of two different sources. The Decision of NEPRA contained a reiteration of the proposed increase in tariff being "within the overall revenue requirement determined by NEPRA", and that "the ultimate goal of the Government is to allow targeted subsidies and recover the cost of electricity." The Government was thus very clear that there was a cost for production of electricity which must be recovered. Since it cannot be done entirely from the consumers, the burden has to be shared by the

Government. Yet, the overall revenue requirement of Discos must not be adversely impacted, thereby.

12. It is an undeniable fact that sale of goods takes place to the consumers and important aspect of the term 'turnover' as defined in section 113(3)(a) of the Ordinance is for the sale of goods to take place from which gross receipts are derived. It does not constrain the sources from which those receipts will be derived which may be one or multiple sources. Discos' misplaced notion that there is in fact no sale to Federal Government has no basis. No sale need take place to the Federal Government and it is enough if it is done to the consumers. The rest is a matter of receipt of money in respect of the transaction of sale which has already taken place. The evasion of tax on this basis would be tantamount to distortion of the concept of subsidy which is a matter between the consumers and the Federal Government.

13. This is also borne out from the audited accounts placed on record upon the directions of this Court by the parties. For example, in respect of GEPCO, it has clearly been stated under the heading 'financial revenue' that **"the tariff differential subsidy worth Rs.28,477 Million is the difference between the tariff determined by NEPRA and the tariff notified by GoP".** Further, under the profit and loss account heading the total revenue of GEPCO includes revenue

from sales of electricity as well as subsidy from GoP. It barely covers the cost of electricity which is calculated at Rs.110.311M as compared to total revenue of Rs.122.135M (for 2017-18). Thus, the audited accounts of Discos clearly show the subsidy from Government of Pakistan as part of the revenue receipts. Similar is the case of LESCO which shows the tariff differential subsidy as receivable from the Government of Pakistan. This amount has also been included in the revenue receipts of LESCO. These documents which are the documents of the Discos leave it in no manner of doubt that the amount of subsidy has been shown as a revenue receipt in the audited accounts. Although it has been mentioned as a subsidy to be reimbursed by the Federal Government, there is no doubt that it forms part of the gross receipts of the Discos derived from sale of goods. The use of term 'subsidy' is notional in our opinion as subsidy is merely in favour of the consumers and Discos derive no benefit out of that subsidy. They are in fact recompensed fully on account of the tariff determined by NEPRA.

14. Similar question came up for hearing before the High Court of Sindh in *inter alia* Income Tax Case No.10 to 89 which was decided on 28.09.2023 and the question of law was determined in the following manner:

> *"18. In essence, the law is that if the payments received are voluntary without there being any legal*

obligation upon them to do so, or without there being any liability or obligation to that effect, then in a certain set of facts, it can be held to be anything other than an income. It could be a capital receipt or against any share consideration. In the present case it is not so. In judging the nature of a receipt, the Courts have to take into account all the circumstances under which the taxpayer may have received the money particularly the purpose for which it was given to the taxpayer. In the instant matter the payment by the government was thus specifically for the purpose of covering losses and it was for that very purpose that the subsidy had been demanded by the taxpayer; consequently, this amount received was a trading receipt and must be held to be income arising from the business of the taxpayer so that it is taxable as such. The payment was no doubt called a subsidy, but it is clear that it was made specifically with the object of compensating the taxpayer for the loss of certain profits which might have arisen if the cotton was not purchased on the price as directed by the Government. This was, therefore an income or receipt by the company which was inseparably connected with the conduct of the business of the company and it arose from that business."

15. Similarly, the Balochistan High Court was also confronted with the issue of law in the following terms:

"1) Whether on the facts and circumstances of the case Appellate Tribunal has erred in holding that the subsidy cannot be made part of turnover as defined in Section 113 of the Income Tax Ordinance, 2001?

2) Whether the "Tariff Differential Subsidy" paid by the government to the taxpayer is in lieu of consideration for sale of electricity to the consumer at the rate below the fixed tariff for such sale?"

In a judgment reported as *CIR v. M/s QESCO* (**2022 PTD 1844**), the question was resolved in favour of the department and the following observations are relevant for our purposes:

"15. Minimum tax is charged as a percentage of total turnover. The term "turnover" is defined as gross receipts from sale of goods, rendering of services and execution of contracts. However the Sales Tax, Federal Excise Duty, trade discount mentioned on invoices and presumptive or final tax regime income are to be excluded from the gross receipts. In the instant reference the taxpayer is engaged into business of sale of electricity to domestic, commercial and industrial consumers.

> *The slabs and rate are determined by the NEPRA. In certain case lesser rates are charged from specific categories of consumers. The electricity supply companies receive certain portion of price of electricity from consumers which is lower than the NEPRA Tariff and the balance is received from the Government in the form of TDS. Thus the TDS is meant for relief to the end consumers. These electric supply companies declare in their audited accounts both the receipts from the consumers and the Government…"*
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> *16. From the above it is clear that TDS is amount receivable from the Government of Pakistan on account of difference between lower than NEPRA Tariff price charged from the consumers and the price notified by the NEPRA. Thus is not a subsidy or grant given to the QESCO as a bailout package.*
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> *22. For what has been discussed above we are of the considered opinion that the amount received / receivable by electric power supply companies from the Government of Pakistan on account of difference between lower than the NEPRA Tariff rate charged to consumers and the rate notified by NEPRA is not subsidy. It is the balance price of electricity which is paid by the Government on behalf of electricity consumers to provide relief to such consumers. The electric power supply companies receive their full price of electricity sold to consumers partly from consumers and partly from the Government."*

16. In conclusion, it is held that the amount recovered from consumers as well as subsidy amount constitute revenue receipts cumulatively liable to tax and comprised in the definition of 'turnover' in section 113 of the Ordinance. The questions of law are answered in favour of the department and against the taxpayers (applicants in some reference applications).

17. Hence ITR Nos.146 of 2016, 196 of 2016, 41 of 2017, 82911 of 2017, 82915 of 2017, 82919 of 2017, 42 of 2017, 75743 of 2021, 75744 of 2021, 75745 of 2021, 75746 of 2021,75747 of 2021, 75748 of 2021 and 75749 of 2021, (filed by the department) are allowed and the

impugned orders are set aside. Similarly, ITR Nos.74708 of 2017, 74710 of 2017, 14763 of 2023, 14774 of 2023, 59530 of 2023, 76238 of 2023, 76250 of 2023 (filed by the taxpayers) are dismissed. The reference applications are ***disposed of*** in these terms.

A copy of this order shall be sent to the Tribunal under the Seal of the Court.

(ASIM HAFEEZ) ***(SHAHID KARIM)***
JUDGE ***JUDGE***

Approved for reporting.

JUDGE ***JUDGE***

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Rafaqat Ali