

BEFORE THE APPELLATE TRIBUNAL, SINDH REVENUE BOARD

DOUBLE BENCH-II

APPEAL NO. AT-198/2015

M/s Sukkur Beverages (Pvt.) Limited Appellant

Versus

Commissioner (Appeals), SRB Respondent

Mr. Nasir Ahmed Malik, Advocate For Appellant

Mr. Turab Ali, Assistant Commissioner, Karachi For Respondent

Date of hearing 11.03.2019

Date of Order 09.04.2019

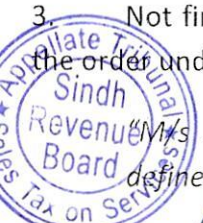
ORDER

Mr. Agha Kafeel Barik: This appeal has been filed against order of Commissioner (Appeals) dated 30.06.2015 whereby he dismissed tax payer's appeal against order in original dated 19.02.2015. The AC-SRB, Sukkur, through his impugned order dated 19.02.2015 charged SST at Rs.40,142,321/- for the period from July, 2011 to June, 2014, beside imposing penalty of Rs.2,007,116/- under section 43(3) of the Act. Brief facts of the case are as under.

2. The AC-SRB Sukkur, on the basis of an information, that the appellant had purchased concentrate, used to bottle / manufacture Pepsi Cola drinks, worth Rs.4,014,232,157 from Pepsi Cola International (Pvt.) Ltd. Lahore during the period from July, 2011 to June, 2014, issued a show cause notice on 22.10.2014 as to why tax and penalty should not be imposed on him as the said services being franchise services were covered under tariff heading 9823.0000 read with Section 2(46) and were taxable, but the appellant had neither paid tax nor filed any sales tax return.

3. Not finding the reply to his show cause notice satisfactory the AC Sukkur SRB finalized the order under section 23 as under.

M/s Sukkur beverages (Pvt.) Ltd. failed to pay Sindh Sales Tax Rs.40,142,321/- as defined in sub (ii) of Rule 36 of Sindh Sales Tax on Services Rules, 2011, read with section



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2(46), (96), 3 and tariff heading 9823.0000 of Second Schedule of Sindh Sales Tax on Services Act, 2011.

"Moreover, as per sub 2 of Rule 36 of Sindh Sales Tax on Services Rules, 2011, M/s Sukkur Beverages (Pvt.) Ltd. were liable to pay / deposit the amount of Sindh Sales Tax Rs.40,142,321/- against these "Franchise Services". Now on the basis of these facts it is confirmed that M/s Sukkur Beverages (Pvt.) Limited A-10, S.I.T.E., Sukkur failed to pay Sales Tax amounting to Rs.40,142,321/- on Franchise services during the tax period July, 2011 to June, 2014 which is violation of section 2(46), 2(71), 3, 8, 9, 16, 17, 24 & 30 of Sindh Sales Tax on Services Act, 2011 read with Rule 36 of Sindh Sales Tax Rules, 2011.

"Therefore, in view of the above, the undersigned is of the opinion the charges levied in the show cause notice are hereby established and order for the recovery of Sindh Sales Tax Rs.40,142,321/- against the taxable services from M/s Sukkur Beverages (Pvt.) Ltd. under section 23 of SST Act 2011 along with default surcharge (calculated at the time of payment) under section 44 of Sindh Sales Tax on Services Act, 2011. I also imposed a penalty of Rs.2,007,116/- under Section 43(3) of Sindh Sales Tax on Services Act, 2011."

4. The Commissioner (Appeals) has discussed the data of sale of concentrate by Pepsi Cola International (Pvt.) Ltd. Lahore from 05.07.2011 to 30.10.2014 (3 financial years) including invoice numbers, concentrate value, FED and sales tax and gross total amount of concentrate amount sold by the said company to the appellant which was Rs.4,014,232,158/- for 3 years. The Commissioner (Appeals) has reproduced this whole data in well over 18 pages of his order in appeal dated 30.06.2015. It is noted that it was already reproduced in the order in original of the AC. The Commissioner (Appeals) held that total value of working of value of consideration / service shall be inclusive of F.E.D. and Federal Sales Tax, 1990, under section 5 read with section 2(99) of the Act on which SST @10% was applicable at Rs.40,142,321/-. After detailed discussion the learned Commissioner (Appeals) confirmed the order in original as amended by him.

It is against this order of Commissioner (Appeals) that the appeal is filed before us.

5. Mr. Nasir Ahmed Malik, Advocate and the learned AR argued that there was no agreement of franchise between the appellant company and the US Company which also acted as principal company yet did not charge any franchise fee or royalty. He argued that the department has charged SST on imaginary franchise fee merely on whims and presumptions whereas there is no presumption in taxing laws. He also presented the audited statement of account for the relevant periods and submitted that no such expense as franchise fee or royalty has been debited in the financials for the said period and as such departmental allegations are false.

6. On the other hand the departmental representative argued that all the letters of appointment issued by the US Principal company to the Bottling companies were nothing but agreements of franchise which bind the bottling companies to purchase concentrate from Pepsi

Cola International (Pvt.) Ltd. Lahore which was selling concentrate of Pepsico Inc. USA under its license and also paying franchise fee @2% on its all-Pakistan sale of concentrate, which in turn was the purchase of 8 bottling companies in Pakistan. These bottling companies were allowed to prepare and bottle various products of Pepsico Inc. USA using its concentrate on one hand and on the other hand they were barred from purchasing any such concentrate from any other source and / or manufacturer or bottle drinks of any other brand of except Pepsico Inc. The learned departmental representative supported the order of the Commissioner (Appeals) also as he said he had reached the right conclusion.

7. There is a tripartite agreement in this international transaction and there are following parties to it, namely;

1. Pepsi Co. Inc. USA (Party No. 1)
2. Pepsi Cola International (Pvt.) Ltd. Lahore (Party No. 2)
3. Eight (8) bottling companies located all over Pakistan, including Sukkur Beverages Ltd. Sukkur and Pakistan Beverages Ltd., Karachi (Party No.3)

According to the tripartite agreement Party No.1 Pepsico Inc. USA sells its basic formula of Pepsi concentrate to party No.2 in Pakistan, which prepares the concentrate and sells it to party No.3 i.e. eight authorized bottlers in Pakistan.

8. As per agreement Party No.2 pays royalty @ 2% of its Pakistan turnover to Pepsico Inc. USA. Party No.2 having exclusive rights over Pepsi Concentrates in Pakistan under the agreement and with the permission of Pepsico Inc. USA sells it to 8 bottling companies in Pakistan under the tripartite agreement. This royalty being paid by Party No.2 to Pepsico Inc. USA is taxed under the category of "franchise fee" under tariff code 9823.0000, by Punjab Revenue Authority (PRA).

9. While party No.3, eight bottling companies, purchase the Pepsi concentrate of USA origin through party No.2 there is apparently no clause in the agreement about the liability of these 8 bottling companies with regard to royalty or franchise fee directly payable to PepsiCo Inc. USA.

10. However, the departmental officers have taken the instance that the price/ value of concentrate being paid by bottling companies to party No.2 includes the amount of royalty/ franchise fee whereas party no.2 in turn pays royalty to party no.1 on its all Pakistan turnover. Thus the appellant is liable to sales tax on the built in portion of royalty/ franchise fee.

11. The A.R has taken defense that neither the bottling companies are liable to pay any franchise fee or royalty, nor they have incurred any expense under this head as evident from their audited statement of accounts for the relevant year. As such the allegation of the department regarding payment of franchise fee / royalty is baseless, and they are not liable to pay any tax under the head "royalty" or "franchise fee".

12. From the terms & conditions of the agreement between PepsiCo Inc. USA and Pepsi Cola International Ltd. Lahore it is abundantly clear that it is a tripartite agreement of three parties;



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the third party being eight (8) bottling companies in Pakistan preparing Pepsi Cola out of concentrate prepared by Pepsi Cola Int. Ltd. Lahore and being purchased by these 8 companies. While PepsiCo Inc. USA has this agreement signed with Pepsi Cola Ltd. Lahore all the terms and conditions bind all other eight (8) bottling Companies equally. Although the US parent company does not charge any franchise fee or royalty directly from these 8 bottling companies, all these are bound by the US parent company in the following manner:

- a. They are under agreement to purchase the concentrate from Pepsi cola Int. Lahore only. The said company prepares this concentrate out of ingredients/formula purchased from US parent company.
- b. None of these Pakistani bottling Companies can purchase any raw material or finished goods from any other company except from Pepsi Cola Int. Ltd. Lahore.
- c. All these bottling companies including two located in Sindh namely Pakistan Beverages and Sukkur Beverages also use the logo of PepsiCo Inc. USA, beside using bottles and cans of specific size, design and color. These goods cannot be purchased from any other competitor either nor logo of any other company can be displayed by these bottling companies.

13. Practically the US principal company licensed Pepsi Cola Int. Company (Pvt.) Ltd. Lahore, which prepares the concentrate and pays royalty @ 2% to US parent company on its all Pakistan turnover. Since the eight (8) bottling companies are preparing Pepsi Cola in bottles & cans they are doing it under license by Pepsi Cola International (Pvt.) Ltd. Lahore which is already under license by US principal company and is an Associate of US Company in such an arrangement.

14. The above arrangement binds all the three parties in a composite agreement. Although the argument of the learned A.R is that the eight (8) bottling companies do not pay any royalty directly or indirectly to US principal company, it is next to impossible that US principal company allows all the operation without charge of any franchise fee. In fact the royalty @ 2% charged by it from Pepsi Cola International (Pvt.) Ltd. Company Lahore is collected by Lahore Company included in the sale price of concentrates sold to eight bottling companies. For doing so the Pepsi Cola Int. Lahore is acting as an Associate and licensee of US Company.

15. Although party No.1 has no direct contract under the head "Franchise" with party No.3, their relationship is well defined under Section 2(46) in which 'franchiser' "includes an associate of the franchiser".

Here in this case party No.2 Pepsico Int. Lahore is an "associate" of party No.1 and in that capacity it is dealing with the party No.3, the eight bottling companies throughout Pakistan.

16. Party No.2 is paying royalty @ 2% on its Pakistan turnover which is based on the sale of Pepsi concentrate. Under the agreement neither party No. 2 can buy concentrate from any other source except party No.1, nor the bottling companies can do the same. The monopoly of PepsiCo/Inc. USA covers all of them. Party No. 2 of Lahore is paying Sales Tax to Punjab Revenue Authority on the franchise fee being paid @ 2% to its US principal company on its total turnover



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of concentrate in Pakistan which is aggregate of its sales of concentrate to all the 8 companies. But it is not paying any sales tax to SRB.

17. It is pertinent to note that there are letters of "appointment of exclusive bottling" issued by Pepsico Inc. USA to all the bottling companies of Pepsi Cola in Pakistan. But there is no franchise agreement between the US Company and the bottling companies while admittedly such an agreement exists between Pepsico Inc. USA and Pepsi Cola International (Pvt.) Ltd. Lahore. In this respect the definition of "franchise" under section 2(46) squarely fits on the relationship between the US company and the eight bottling companies. For the sake of convenience it is reproduced below.

Section 2(46) "Franchise" means an authority given by a franchiser, including an associate of the franchiser, under which the franchisee is contractually or otherwise granted any right to produce, manufacture, distribute sell or trade or otherwise deal in or do any other business activity in respect of goods or to provide services or to undertake any process identified with the [franchiser, whether or not against] a consideration or fee, including technical fee, management fee, or royalty or such other fee or charges, irrespective of the fact whether or not a trademark, service mark, trade name, logo, brand name or any such representation or symbol, as the case may be, is involved; [emphasis supplied]

18. We also have Rule 36 laying down special procedure for payment of tax on franchise services. Sub-rule (ii) (before amendment) lays down the situation where there is no formal agreement as in the present case. It reads as under.

"36 (ii) In case where franchisers are foreign or local beverage companies, if there is no formal agreement between the franchiser or franchisee, the assessable value for the purpose of levy of sales tax shall be 10% of the value of concentrate supplied by the franchiser to the franchisee. However, in such cases where proper remittance or payment of fee or royalty is being made by the franchisee beverage company to the local or foreign franchiser under a proper agreement, the assessable value shall be the gross amount of fee or royalty remitted or paid to the franchiser or the amount laid down in the agreement;"

19. Under the said provision of law the value of service rendered by the appellant company shall be an amount equal to 10% of the value of the beverages concentrate supplied by the franchiser to the franchisee, or an amount equal to 10% of the turnover of the franchiser, whichever is higher. Here the franchiser includes 'an associate of the franchiser' under the definition of "franchise" under Section 2(46) of the Act. As discussed above at length M/s Pepsi Cola International (Pvt.) Ltd. has been working as an associate of Pepsico Inc. USA, by preparing its concentrate and selling it alongwith its logo, trade mark etc. to 8 bottling companies in Pakistan including two located in Sindh. Hence applying rule 36(ii) and of rule 36(4) read with Section 2(46) this bottling company of Pepsi Cola located in Sindh, namely Pakistan Beverages (Pvt.) Ltd. shall be liable to be taxed in Sindh on its value of service which will be worked out @10% on its respective gross turnover for the relevant financial year, as it would definitely be



higher than their respective purchase value of concentrate from Pepsi Cola International (Pvt.) Ltd. Lahore. The impugned order of the Commissioner (Appeals) is confirmed on this issue.

20. The AC Sukkur, while passing assessment order under section 23 / 47 (1A) has also passed order under section 43(3) imposing penalty of Rs.2,007,116/-. The Commissioner (Appeals) also confirmed the penalty as well as default surcharge without any reasons only on the basis of maintenance of assessment order by him. Earlier the assessing officer had confronted the appellant of his intention to impose penalty vide his Show cause notice dated 22.10.2014 as under.


"M/s Sukkur Beverages (Pvt.) Ltd. are also required to explain as to why penal action under clause 3, 6(d), 11, 12 and 13 of the table in section 43 of 2011 Act should not be taken against them for contravention of section 2(46), 2(71), 3, 8, 9, 17, 24 and 30 of SST Act, 2011 read with Rule 36 of the SST Rules, 2011".

However, in the assessment order he dropped charged about four clauses of section 43 but imposed penalty of 2,007,116 under section 43(3) only in the following words.

"I also impose a penalty of 2,007,116 under section 43(3) of SST Act, 2011".

21. We do not think that any penalty without first establishing any charges, which lead to the invocation of a penalty provision, is maintainable in the eyes of law. This is one of the bald orders we have seen from the officers of SRB. The Commissioner (Appeals) has not commented on this aspect of the order of penalty and has given his own reasons to justify imposition of penalty, particularly as he has confirmed the order in original. In view of these findings we set aside the order to the extent of penalty under section 43(3) and allow the appeal partly.

22. The appeal is disposed of accordingly.


(Muhammad Ashfaq Balouch)
MEMBER JUDICIAL

Karachi
Dated: 09.04.2019

Copies supplied for compliance:-

1. The Appellant through authorized Representative.
2. The Assistant Commissioner (Unit-), SRB, Karachi.

Copy for information to :-

- 3) The Commissioner (Appeals), SRB, Karachi.
- 4) Office Copy.
- 5) Guard File.


(Agha Kafeel Barik)
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