

(Guard file)

BEFORE THE APPELLATE TRIBUNAL, SINDH REVENUE BOARD

DOUBLE BENCH-II

APPEAL NO. AT-18/2017

M/s Pak Gulf Leasing Co. Limited Appellant

Versus

Commissioner (Appeals), SRB Respondent

Mr. Mian Mukhtar, Advocate For Appellant

Mr. Zohaib Athar, Assistant Commissioner, Karachi For Respondent

Date of hearing 25.04.2019
Date of Order 30.04.2019

ORDER

Muhammad Ashfaq Balouch: An appeal has been filed against order of Commissioner (Appeals) dated 01.03.2017 whereby he confirmed the order in original dated 15.06.2016. The facts of the case briefly, as stated in Order-in-Original, are that the appellant got voluntarily registered on 26.08.2011 as service provider in respect of leasing under tariff heading 9813.3010 of the Second Schedule of the Sindh Sales Tax on Services Act, 2011 on which SST at the rate of 16% of the value of service is payable w.e.f. July 01, 2011. The registered person was alleged of non-payment / short payment of Sindh Sales tax in relation to commitment fees amounting to Rs.17,050/- and 161,162/- during the tax year 2014 and 2013 on which SST was payable at Rs.2,728 and 25,786/- respectively. The registered person was also alleged for non-payment of Sindh sales tax on processing fees amounting to Rs.260,545/- (being 16% of 1,628,417/-) its IJARA returns for the tax year 2012. Lastly, the registered person was alleged for non-payment of Sindh Sales Tax amounting Rs.2,353,342/- on its IJARA services consideration for the tax years 2013, 2014 and 2015 along with penalty of Rs.132,120/-. On appeal the Commissioner (Appeals) confirmed the order in original in toto.

2. The learned A.R. contended that section 3(1)(b) of Sindh sales Tax on Services Act, 2011 ('Act, 2011') states:3(1) A taxable service is a service listed in the Second Schedule to this act, which is provided as (b) in the course of an economic activity including in the commencement or termination of activity. Furthermore, section 4(1)(b) of the Act, 2011 states, an economic



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activity means any activity carried on by a person that involves or is intended to involve the provision of services to another person and includes: b) the supply of moveable property by way of lease, license or similar arrangements.

3. The AR further contended that tariff heading 98.13 of Second Schedule to the Act, 2011 is read as "Services provided by banking companies, insurance companies, co-operative financing societies, modaraba, musharikas, leasing companies, foreign exchange dealers, non-banking financial institution and other person dealing in such services".

4. The AR also referred to the Rule 30(1) and (2) of the Sindh Sales Tax on Services Rules, 2011 ('Rules, 2011') which states; (1) the provisions of these rules shall apply for collection of sales tax on services by persons providing or rendering the service specified under tariff heading 98.13 (including the sub-heading thereof) of the Second Schedule to the Act).

"(2) Every banking company, [cooperative financing society, modaraba, musharika, leasing company, foreign exchange dealer, non-banking financial institutions, companies providing management services including fund and asset management services and other persons dealing in such services, hereinafter referred to in this rule as 'company or institution',] shall pay the sales tax leviable on services rendered or provided at any person **except**[***] umra and hajj services [and the services of cheque book issuance and][***] **Musharika and Modaraba Financing**

5. The tax under these rules shall be paid by the [company or institution] on the gross amount charged for service provided to the customer **excluding mark-up or interest**. Appellant further submitted that the amount regarding ijarah income is related to 'Ijarah Munthiyah Bittamleek' is a fund based activity similar to finance lease on which only mark-up / interest constitutes income no sales tax is chargeable on it as per the provisions of Act, 2011 read with Rules, 2011. The word supply as mentioned in section 4(1) b of the 'Act, 2011' does not apply to the sale / lease of an asset under a leasing arrangement because such an arrangement is fictionalized for the purpose of obtaining a finance facility.

6. The learned AR submitted that the requirement of Islamic Financial Accounting Standard under which the whole of ijarah rental is shown as accounting income instead of the profit component only is an accounting income intended to give the transaction an Islamic appearance / form and in no way implies that whole of the ijarah rental constitutes the income of the leasing company. In an ijarah 100% depreciation is admissible on the assets leased under a leasing arrangement under the lease period. This being case in the lease / ijarah arrangement only profit is ultimately recognized as income. If the whole of the ijarah rental is treated as value of service the amount of sales tax chargeable on the gross ijarah rental amount far exceeds the revenue and profit of the leasing company.

7. The AR further contended that the leasing activities that are undertaken by leasing companies have been held as fund based activities by Securities and Exchange Commission of Pakistan (SECP), State Bank of Pakistan (SBP), Income Tax Appellant Tribunal (ITAT) later renamed as Appellate Tribunal of Inland Revenue (ATIR) and Shariah Advisor as is evident from the following facts:

A clarification letter dated December 14, 2015 was written by the chairman SECP to FBR to the effect that since lease finance is a fund based finance facility worldwide therefore it does not constitute a service; contents of the letter are re-produced as under:

"As you know, leasing companies are licensed financial institutions. Previously, these companies were regulated by State Bank of Pakistan (SBP) and now fall under the regulatory ambit of Securities and Exchange Commission of Pakistan (SECP). Being a financial institution, the major source of earning for leasing companies is the interest / mark-up on the lease finance facilities provided to their clients. Lease finance is a recognized fund based finance facility in terms of international Finance Accounting Standards and the existing regulatory framework governing the leasing business. Accordingly, the income earned by the leasing companies on their portfolio is classified as interest / mark-up."

8. The AR further presented their viewpoint by quoting the Order PTR No.20 of 2001 dated 10th April, 2008 which states that *Firstly the tribunal find the action of sale by the petitioner company to Madaraba Company is not covered within the definition of supply for the simple reason that it is not a perpetual and permanent arrangement and a one-time transaction. The arrangement in the opinion of the Income Tax Appellate Tribunal was more in the shape of an arrangement for obtaining finance than actual transfer of the asset. Furthermore, that the petitioner was neither in the business of purchase and neither sale of assets nor the custody of the assets was ever transferred to Modaraba Company physically. The arrangement was not event a sale hence there was no need to call its supplies either. This has been held for the reasons that the arrangement in its essence is a substitute of similar other matter of getting finances, wherein the borrower provides security by pledging its assets against such loan arrangement. The transaction, therefore, is nothing more than production of a security in terms of pledge of the machinery to the Modaraba Company.*

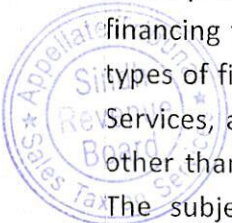
9. Leasing, being a form of financing, is a fund based activity and is also recognized as such by the Securities and Exchange Companies of Pakistan (SECP); the State Bank of Pakistan (SBP), Sharia Laws (as interpreted by the Sharia Advisor), and the Income Tax Appellate Tribunal (ITAR). Essentially Leasing is no different from loaning by Commercial Bank, except that the commercial banks insists on obtaining additional collateral assets from the borrowers to secure their loan. Lease financing, on the other hand, is Asset-based financing, whereby the Leasing Companies are legally and technically deemed to be owners of the relative Leased Assets till the

Maturity of the concerned Lease. This entitles a Leasing Company to legally re-posses the assets, in the event that the lessee defaults on honoring his financial commitments under the relative Lease Agreement. Leasing, is therefore, a financing option which primarily targets business entities, whether small or medium, which are not in position to offer additional collateral securities to a lending commercial bank to securitize their borrowing from banks.

10. Leasing being a Fund-based Activity, where a Leasing Company actually uses its own funds to acquire the Assets to be leased to its Lessees under a Lease Agreement which determines the periodic Repayment of the Principal amount of such funds by way of Lease Rentals, including the Mark-up on the funding provided to acquire that Asset, the usufruct for which is assigned for a specified period of time to the Lessee, is clearly a Fund-based Activity. It should be understood that a Lessee cannot make use of the Leased Asset, purchase of which is financed, under either an Ijarah or a Lease, out of funds belonging to the Leasing Company, which are at a certain cost to the Leasing Company concerned. Consequently, based on this realization, provisions of Rule-30(4) of Chapter-VI of the Sindh Sales Tax on Services Act, 2011, excludes the amount of Mark-up / Interest Earned on the Loan / Financing Amount from the Gross Amount of Services rendered. Although, the Repayment of the Principal Amount of Loan never formed a part of the Gross Amount of Services rendered, yet to clarify the matter Do No.SRB-STM-3-4/414/2011 dated 24.11.2011 was issued by the SRB to the effect that no Tax will be chargeable on the Principal Amount representing Repayment of Loan, as well as on interest / Mark-up thereon.

11. Finance Lease and Ijarah (IMB) are identical in nature. The former is based on the conventional Mode of Financing, while the latter derives its origin from a Sharia-compliant, Islamic Mode of Financing. In both the cases, the periodically received Repayment Rental by the relative Leasing Company comprises of the Principal Amount of Loan / Financing, as well as the interest / Mark-up thereon.

12. With regard to the taxability of Ijarah the AC submitted that the service of 'Ijarah Munthiyah Bittamleek' is not a fund based activity. As a fund based activity is one where the subject matter usufruct of the amount of money which in case of 'Ijarah Munthiyah Bittamleek' is not present as in this case the subject matter is the usufruct of the asset, hence it is not a financing transaction, instead it is a substitute of financing transaction. The AC-SRB explained types of financial services in order to differentiate between different types of Islamic Financial Services, and about Ijarah he submitted that Ijarah is a contract whereby, owner of an asset, other than consumables, transfer its usufruct to another person for an agreed consideration. The subject matter is usufruct to another person for an agreed period for an agreed consideration. The subject matter is the usufruct of the asset and not the amount of money as in case of finance lease.



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13. He further argued that the term of Ijarah contract includes that the asset is leased for a specific purpose i.e. lessee cannot use the asset for any purpose other than the purpose specified in the lease, the lessee is liable to compensate the lessor for any harm to the leased asset, rent should be charged after the delivery of the leased asset, repair and maintenance is the responsibility of the lessor, Ijarah payment shall be stopped if asset is out of order. No hidden registration / tax related fees and expenses, no hidden takaful (insurance) payment, the asset will be owned by the lessor and after the expiry of leased period lessor is at liberty to renew the Ijarah agreement, lease it to another party or transfer it to lessee but the transfer of lease is through a separate agreement which is not the part of Ijarah agreement.

14. The AC also pointed out that Note No.11 of their financial statements for the year ended 2015 revealed that asset is a part of their fixed asset stream i.e. these assets are recorded as operating fixed asset and is depreciated within the books of Pak Gulf Leasing Company Limited.

15. With regard to the appellant's contention that Ijarah is a fund based activity, the AC argued that for fund based activity, the income for the company is only interest income whereas in case of Pak Gulf Leasing whole of the rentals are charged under the head of income from Ijarah Operations.

16. The contention of the appellant that only markup constitutes turnover and the services provided by the appellant are similar to those provided by banks is unacceptable Banks being financial institutions provide loan whereby the underlying asset is money and the income for bank is the markup amount that is parked within the financial statement as income. Whereas in case of Ijarah the underlying asset is the commodity / equipment not money which makes it different from the banking services. Also, there is a point to note that the appellant receives rentals from its customer which is recorded as income which in case of banks is completely different as only markup is treated as income.

17. With regard to the Judgment of Lahore High Court in order No.PTR No.20 of 2001 dated 10th April, 2018, whereby sale made by the petitioner to Modaraba is discussed and a point has been raised that petitioner was neither in business of purchase or sale nor the custody was transferred to Modaraba Company physically. In this relation, it is hereby stated that the assets on Ijarah are recorded within the books of the appellant, depreciated within their books and the same is deducted as an expense from their books. In case, these assets would have been finance leased, the assets would not have been a part of appellant's books of account.

18. The AC submitted that as per NBFC Rules, 2003, leasing is defined as financial services provided on operating lease or finance lease basis, in accordance with International Accounting Standard. The term NBFC is defined a non-banking financing company which includes company licensed by the commission to carry out any one or more forms of business as specified in clause (a) of Section 282A of the Companies Ordinance, 1984 and that Section 282A of

Companies Ordinance lists down the companies classified as Non-Banking Financing Companies, including leasing companies.

19. There are two types of lease.

- 1) Operating lease: An **operating lease** is a contract that allows for the use of an asset but does not transfer rights of ownership of the asset. An **operating lease** represents an off-balance sheet financing of assets, where a **leased** asset and associated liabilities of future rent payments are not included on the balance sheet of a company.
- 2) Finance Lease: A **finance lease** is a way of providing **finance** – effectively a **leasing** company (the lessor or owner) buys the asset for the user (usually called the hirer or lessee) and rents it to them for an agreed period.

20. It is also important to distinguish between Ijarah and finance lease; The same are defined here under:

Ijarah: to transfer the usage of a non-consumable asset by the owner(lessor) to another person (the lessee) for an agreed period, at an agreed price (rent)

Finance lease: a contract by which one party transfers asset to another for a predefined period, usually in return for an interest.'

In Ijarah (Islamic lease) the asset is leased for a specific purpose i.e. and the asset cannot be used for any other purpose other than the one specified in the contract. The asset is recorded in the books of the appellant and is so depreciated as an expense from the books of the appellant. The asset is registered in the name of appellant and repair/maintenance is the responsibility of appellant. Therefore, it becomes taxable under sections 3(1) and 4(1) of the Act, 2011 under the head of supply of moveable property by way of lease under tariff heading 9813.3020 of second schedule to the Act, 2011.

21. The learned AC also submitted, with regards to the appellant's contention (that incase of taxability only profit should be taxed as this is the income from Ijarah) that section 5(1) (a) of the Act, 2011 defines value of taxable services as 'the consideration in money including all Federal and provincial duties and taxes, if any, which the person receives from the recipient of the service but excluding the amount sales tax under this Act.' However, as the registered person has been taxed on the amount as recorded under the head revenue therefore, the taxable amount cannot be the profit instead whole of the amount recorded within the financial statement.

22. In respect of the clarification presented by the AC-SRB vide SRB letter No. SRB-STM-3-4/414/2011 dated 24-08-2011, it is hereby noted that the Board has only exempted the



modaraba and musharika financing and lease payment to the extent of principal sum and markup interest as per Rule 30(4) of the Rules, 2011. However, in case of Ijarah there is no such thing as markup / interest. The company receives profit and rental therefore, the same is not applicable.

23. Lastly, the AC argued that the term finance is defined by NBFC Rules as "finance" means provision of,- (i) any accommodation or facility on the basis of participation in profit and loss, musharika or modaraba basis, mark-up or mark-down in price, hire purchase, lease, rent-sharing, bills of exchange, promissory notes or other instruments with or without buy-back arrangement by a seller, participation term certificate, musharika or modaraba certificate, term finance certificate; (ii) guarantees, indemnities, letters of credit or any other financial engagement, issued or undertaken on behalf of a person, with a corresponding obligation of that person; (iii) a loan, advance, discounting services to any person; (iv) micro financing including any form of finance such as leases advances, consumer loans, housing finance."

From above it can be seen that the definition of finance nowhere includes the Ijarah services.

24. We have gone through the arguments of both the sides. With regard to the 'commitment fees' it is noted that Rule 30(2) of Rules, 2011 imposes sales tax on all the services rendered or provided by the person. The term 'commitment fees' is defined as the fees charged by a lender to a borrower for an unused credit line or undisbursed loan. It is generally specified as a fixed percentage of undisbursed loan amount. Therefore, Sindh Sales Tax on commitment fees is applicable as per tariff heading 9813.3000 of second schedule to the Act, 2011.

25. With regard to the imposition of Sindh Sales Tax on "processing fees" during tax year 2012 it is hereby noted that the same is charged for processing an application of lease. Such fees is charged to cover the cost of service involved in the processing of the application including credit checks, property appraisal and basic administrative cost. Since, Rule 30(2) of the Rules, 2011 covers all such taxable activities by such listed service providers except musharika and modaraba financing, which the present appellant is not, we hold that "processing fees" amounting to Rs. 1,628,417/- is liable to be taxed under tariff heading 9813.3020 of second schedule to the Act, 2011 amounting to Rs. 260,545/- (being 16% of Rs. 1,628,417/-) which is payable.


26. With regard to commitment fees we have observed that since the issue was settled at the level of Commissioner (Appeals) and tax thereon has been fully paid there is no need of further discussion on it.

27. Last but not the least, we hold that sales tax on the consideration against Ijara services amounting to Rs.2,353,342/- is rightly imposed by the AC as it is a taxable service, not being a finance lease but an arrangement similar to operating lease. Therefore, the same is taxable

Under tariff heading 9813.3020 of Second Schedule to the Act, 2011 read with section 3(1) and 4(1)(b) of Act, 2011 and stands payable.

28. As a result of above the appeal is hereby dismissed.

(Agha Kafeel Barik)
MEMBER TECHNICAL


(Muhammad Ashfaq Balouch)
MEMBER JUDICIAL

Karachi

Dated: 30.04.2019

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.

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APPELLATE TRIBUNAL
SINDH REVENUE BOARD

Order issued on 30/4/19

Registrar

Order Dispatched on 30/4/19

Registrar