BEFORE THE APPELLATE TRIBUNAL, SINDH REVENUE BOARD

DOUBLE BENCH-II

APPEAL NO. AT-21/2017

M/s Pakistan Beverages 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: An appeal has been filed in this case against order of Commissioner (Appeals) dated 13.03.2017 whereby he confirmed order in original of AC (Unit-10), SRB dated 28.11.2014.

2. The facts of the case are as under.

The AC (Unit-10) SRB, on the basis of an information, in the form of a Pepsi Cola Exclusive Bottling Appointment Agreement dated 15.06.2005, issued a show cause notice on 05.05.2014 as to why its turnover of Rs.16.352 billion for the period from July, 2011 to June, 2012 may not be subjected to SST as the appellant was receiving franchise services from Pepsi Cola Inc. USA which are taxable under tariff heading 9823.0000 read with Rule 36(ii) and as to why the value of service should not be calculated @10% on which SST be worked out @10%. The counsel of the appellant vehemently contested the action stating that Rule 36(ii) provides for the methodology of the case when franchise services are established whereas, as per claim of the appellant, it was not yet so established, hence Rule 36(ii) was not applicable.

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3. The AC (Unit-10) did not accept the plea of the AR and asked for various details and documents including purchase orders for the period from July, 2011 to June, 2012 to work out the value of concentrate purchased from Pepsi Cola International (Pvt.) Ltd. Lahore, which were not provided. However, purchase orders for the month of October, 2014 were furnished to the assessing officer as sample. The AC (Unit-10) took the figures of purchases of Rs.476,619,712/- for the month of October, 2014 as basis to work out total purchases of concentrate for 12

months from July, 2011 to June, 2012 and multiplied it by 12 to arrive at the figures of 5,719,436,544 as value of concentrate for financial year 2011-2012. She imposed SST 10% on this value to arrive at the SST payable Rs.571,943,655/- and assessed the same under section 23 read with 47(1A), beside imposing penalties total amounting to Rs.1,365,000/- under various sub-sections of section 43 of the Act.

4. However, it is noted that grave calculation mistakes were committed in the concluding paragraph 15(vi) of the order by the assessing officer while finalizing the assessment under section 23 / 47 (1A). Since the data of concentrate purchase for the period from July, 2011 to June, 2012 was not available with the AC, she estimated it on the basis of data made available to her for the month of October, 2014 as a sample. She just multiplied 476,619,712 by 12 to arrive at 5,719,436,544 as the purchase value of concentrate for the financial year July, 2011 to June, 2012. She further committed a blunder by imposing SST @ 10% on the total purchase value of concentrates to arrive at SST payable at 571,943,655, instead of imposing SST @ 10% on the value of service / consideration which would be 10% of the total value of purchase of concentrate for the whole year.

However, 2nd part of the mistake i.e. Sales Tax imposed @ 10% on total purchases was corrected by the AC herself vide a corrigendum dated 03.12.2014, whereby SST was imposed @10% on the value of services which was worked out @10% of the value of purchases as laid down in Rule 36(ii). The principal amount of SST was thus reduced from 5,719,436,366 to 571,943,655 by the AC herself. During the proceedings of hearing of appeal the Commissioner (Appeals) further observed that the estimation of 12 months purchases value on the basis of just one month (October 2014) basis was a fallacy. Therefore he called for the copy of agreement and complete data of sale of concentrate from the Pepsi Cola Int. Lahore to the appellant company for the period from July, 2011 to June, 2012. After reconciliation with the assistance of both the sides, total value of concentrate purchase of the appellant company for the relevant period was worked out to 4,116,893,055, 10% of which was taken as consideration on which SST @10% amounting to Rs.41,168,930 was worked out as payable, (4,116,893,055 x 10% x 10%) as per para 02 of Commissioner (Appeal) order.

5. The Commissioner (Appeals) vide his order dated 13.03.2017 confirmed the order in original with the observation that the case is amply covered under Rule 36(ii) / 36(4) of the Rules. However, he altered the order in original with the following note.

"6. In view of the above findings, the OIO is upheld in principle and it is held that the Appellant is a franchisee of the PEPSICO US and is liable to pay the Sindh Sales Tax on Services at the applicable rate. However, the OIO is altered as in the case of value of services taken on actual basis after the reconciliation provided by the Appellant and the Pepsico Lahore. The Appellant is directed to comply with the law and to pay theamount of tax determined above in para 1 forthwith and also to pay the default surcharge to be calculated at the time of payment. However, the Appellant shall only be required to pay the penalties imposed in the event of failure to pay the tax and default surcharge within a period of 15 days of receipt of this Order."

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

6. 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 from July, 2011 to June, 2012 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.

7. 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.

8. 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)

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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.

9. 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).

10. 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.

11. 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.

12. 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".

13. 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; 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.

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14. 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.

15. 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.

16. 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.

17. 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 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.

18. 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]

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19. 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 byt eh 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;"

20. 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.

21. The assessing officer has imposed various penalties (6) under Section 43 in the order in original. However, no substantive reasons are given for imposition of so many penalties totally Rs.1,365,000, except a sweeping remark in the show cause notice as well as in theorder in original as under.

Show Cause Notice

M/s Pakistan Beverages Limited are hereby called upon to show cause with 7 days of the receipt of this notice that as to why the Sindh Sales Tax on Services amounting to Rs.1,635,213,352.8/- may be assessed and recovered in terms of the provisions of section 23(1) and section 47(1A)(a) of the Act in addition to the imposition of default surcharge under section 44 of the Act and also penalties mentioned at Sr. No.1, 2, 3, 4, 5, 6(d), 11, 12, 13 and 15 of the table under section 43 of the Act.

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In the order in original the penalties are imposed in a chart without any discussion and without establishing mens rea in any case. We find a simple line on the issue of penalties as under:

"Furthermore penalties under clauses 1, 2, 3, 6(d), 11, 13 & 15 of the table under section 44 are also imposed as shown in the following table." In the last column of the table subject or title of the respective penalty is noted which is wrongly captioned as "reason". Apparently such casual manner in which a tax payer is being penalized is not tenable in the eyes of law. It is expected that a tax payer should be confronted with the specific default in the show cause notice alongwith amount of penalty liable to be imposed. The assessment order should be a speaking order with detailed discussion alongwith the reply of the taxpayer, if any, to the show cause notice by which he was confronted. The Commissioner (Appeals) has adjudged the issue with the following words;

"However, the appellant shall only be required to pay the penalties imposed in the event of failure to pay tax and default surcharge within a period of 15 days of the receipt of this order".

22. Apparently, the appellant did not pay any tax as per impugned order, and the facility stands withdrawn. In view of the above discussion we set aside penalties. However, the assessing officer can impose any penalty by a fresh show cause notice with specific charge confronting the appellant and can pass an independent speaking order.

23. The appeal is disposed of accordingly.

(Muhammad Ashfaq Balouch)
MEMBER JUDICIAL

(Agha Kafeel Barik)
MEMBER TECHNICAL

Karachi
Dated: 09.04.2019

Certified to be True Copy

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APPELLATE TRIBUNAL
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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.