(Guard file)

BEFORE THE APPELLATE TRIBUNAL SINDH REVENUE BOARD AT KARACHI

DB-I

APPEAL NO. AT- 11 /2018

M/s Shan Foods (Pvt) Ltd..... .....Appellant

Versus

Assistant Commissioner, SRB, Karachi.....Respondent

Mr. Adnan Mufti, FCA along with Mr. Muhammad Umair, ITP for Appellant

Mr.Turab Ali, AC and along with Mr. Muhammad Rehmatullah, Internee Officer, SRB for Respondent

Date of hearing 28.03.2018 and 28.05.2018

Date of Order 07.06.2018

ORDER

Justice ® Nadeem Azhar Siddiqi: This appeal has been filed by the appellant challenging the Order-in-Appeal No.26/2018 dated 13.02.2018 passed by the Commissioner (Appeals) in Appeal No. 153/2017 filed by the Appellant against the Order-in-Original No. 262/2017 dated 18.09.2017 passed by the Assistant Commissioner (Ms. Anum Shaikh) SRB, Karachi.

01. The facts of the case as mentioned in the Order-in-Original are that the appellant is registered with SRB under the category of Franchise Services falling under Tariff Heading 9823.0000 of the 2nd schedule of the Sindh Sales Tax on Service Act, 2011 (herein after referred as the Act) and chargeable to Sindh Sales Tax on Services @ 10% with effect from 01.07.2011. It was further stated in the order in original that the appellant has a franchise agreement namely "Trademark User Agreement" with Shan FZC, UAE (hereinafter referred to as Shan, UAE) and under Article 15 of the said agreement the appellant is liable to pay royalty @ 5% of the net sale.

02. It was alleged in the Order-in-Original that examination of the Annual Audited Accounts for the year ended June, 2015 and June, 2014 shows that appellant has paid a total amount of Rs.420,371,532/= and 380,542,853/= for the tax periods July, 2013 to June, 2015 on account of royalty. It was also alleged that the amount of Rs.800,914,385/= is chargeable to Sindh Sales Tax , however the returns filed by appellant show that an amount of Rs.34,724,118/= has been shown in the sales tax returns on account of Royalty, thus there appears short payment of Rs.45,367,320/=.

03. That a show-cause notice dated 05.04.2017 was served upon the appellant to explain as to why short paid amount of Rs.45,367,320/= may not be assessed under section 23 of the Act and recovered under section 47 (1A) of the Act of 2011 along with default surcharge under section 44 of the Act and penalties under serial No. 3, 6(d), 11, 12 and 13 of the Table of Section 43 of the Act.

04. The appellant filed its reply dated 13.04.2017. In the reply it has been stated that the appellant has paid all dues since its registration. However after 2014 the provision of royalty has been made but the amount was not paid as the agreement with Shan, UAE was ceased for the time being as there is a dispute between appellant and FBR regarding its admissibility as an expense. It was further stated that the Royalty expense was disallowed by FBR adding it in taxable income, hence compelling appellant to pay extra tax on income. The appellant has also placed on record of the Assessing Officer the copy of the Order of ATIR disallowing royalty as expenses.

05. The Assessing Officer after hearing passed Order-in-Original determining the sales tax of Rs.38,086.280/= for the tax periods from July, 2013 to June, 2015 along with default surcharge and penalty of Rs.1,904,314/= under section 43 (3) of the Act.

06. The appellant challenged the said order of the Assessing Officer by way of filing appeal before the Commissioner (Appeals), who dismissed the appeal upholding the order in original in toto. The appellant has now challenged the said order in appeal passed by the Commissioner (Appeals) before this forum.

07. Mr. Adnan Mufti, FCA learned Representative for the appellant submitted as under:

i) He challenged that SCN cannot be issued under section 23(1) to a service recipient as section 23(1) is only applicable to service provider who had fails to pay the tax due on taxable services provided by it or has made short payment.

ii) He then submitted that no franchise services have been acquired as acquiring right under agreement to use Logo is not franchise rather acquiring right and this point is subjudice before the Honorable High Court in CPD No.7065/2017 in which the SRB was restrained from recovering tax under tariff heading 9823.0000 and 9838.0000.

iii) He then submitted that to collect tax from the appellant the department has invoked sub section (2) of section 9 read with sub section (2) of section 3 of the Act of 2011, and submitted that both these provisions do not specify/ define the words "non-resident", and that non-resident was only mentioned with reference to 5 services provided under sub-rule (5) of Rule 3 of The Sindh Sales Tax Special Procedure (Withholding) Rules, 2014 (hereinafter referred to as Withholding Rules) and the services of franchise is not included in those 5 services. He also submitted that this point is also under consideration before the High Court of Sindh and placed on record the photo copy of order of High Court of Sindh in Constitution Petition No. D-8485/2017 (Lucky Electric Power Company Limited versus Province of Sindh and others).

iv) He then submitted that according to SRB the tax on franchise services is to be levied on accrual basis and not on the basis of actual payment. He then submitted that the tax cannot be levied on accrual basis, especially in the back drop that the alleged Agreement of Franchise was revoked.

v) He then submitted that the ATIR in its decision held that no franchise service has been acquired and for that reason the royalty as expense

was not allowed. He then submitted that one document cannot be differently interpreted by two departments and two different appellate authorities under fiscal laws.

vi) He challenged the imposition of penalties and default surcharge on the ground that mensrea and willfulness are lacking and department failed to establish the same.

08. Mr. Turab Ali, AC for the Department submitted as under:

i) He submitted that by virtue of section 24(3) assessment of service recipient can be made under section 23(1) of the Act. He then referred to sub section (68) of Section 2 of the Act and submitted that provisions of service or providing of service also includes reception and consumption of service.

ii) He referred to clause 3(a) of Trade Marks License Agreement between M/s Shan Foods (Pvt.) Ltd. and M/s Shan, FZC, UAE (Shan, UAE) and submitted that from this clause it is clear that trade mark rights were granted to appellant to use the trade marks for the purpose of manufacturing, marketing and selling of products.

iii) He then submitted that the appellant has not invoke the constitutional jurisdiction of the High Court of Sindh and the order is binding to the parties to the petition and not on others and that the petition was filed for the reason that their input tax adjustment was not allowed by the department for the reason of lesser rate of tax, which is now allowed vide notification dated 16.05.2018 and now the input tax can be claimed if incurred in providing and rendering taxable services.

v) He then submitted that since the franchiser is placed outside Pakistan and the service recipient is available in Pakistan and is liable to deposit the whole amount of tax under sub section (2) of section 9 of the Act read with Rule 36(iv) of The Sindh Sales Tax on Services Rules, 2011 (herein after referred to as the Rules, 2011) and submitted that Withholding Rules are not applicable in this case.

vi) He then submitted that mere revocation of agreement will not discharge the appellant from the liability of payment of tax. He then submitted that

letter of 17th January, 2017 is not a revocation letter but an information of withholding of amount. He then referred to the clause (1) of sub section (2) of Section 17 of the Act and submitted that since the services were provided by Shan, UAE and received by the appellant the payment of tax becomes due and payable in the tax period during which service was provided.

vii)He then referred to sub rule (v) of Rule 36 of Rules, 2011 and submitted that sales tax is payable on the 15th day of the month following the payment month and in this regard referred to clause 15 of the Agreement which provides the date of payment as 31st March of the following year.

Viii) He then submitted that the order of ATIR was under the Income Tax Ordinance 2001 and not binding upon the department. Income Tax Ordinance 2011 and Sales Tax on Services Tax Act 2011 are two different laws having no overriding effect and will apply to their own fields.

ix) He then submitted that mensrea is available as the payment of tax was withheld on an irrelevant ground in presence of specific provision of Rule 36(v) of Rule, 2011 read with Section 17(2) (i) of the Act and clause 15 of the Agreement.

09. Mr. Adnan Mufti in rebuttal submitted that the provisions of registration cannot be made applicable for assessment as before 2016 the department had no power to make assessment against withholding agent and referred to sub section (1B) of Section 47 of the Act which was effective from 1st July 2016 which provides for assessment of withholding agents for not paying withholding the tax. He then submitted that non-resident outside Pakistan has not been defined in the Act or the Withholding Rules. He referred to the order of High Court in Lucky Electric Power and submitted that section 9(2) and section 3(2) will have to be studied and examined in the light of the withholding rules. He then submitted that section 17(2) of the Act is to be read in conjunction with 17(1) and the said sections are applicable to service providers and not recipients. Mr. Adnan also submitted that nothing has been concealed and suppressed and reason for non-payment of tax has been declared and where there was a genuine dispute regarding the chargeability of

tax, unless mensrea is proved, no default surcharge and penalties can be imposed.

10. Mr. Turab Ali submitted that Withholding Rules were framed under section 13(2), 3(4) and 9(3) and 72 of the Act and are not applicable in this case and that Rule 36 (iv) of the Rules, 2011 is applicable and the appellant being recipient of franchise services from outside Pakistan it is liable to pay tax.

We have heard the learned representative of the parties and perused the record made available before us.

11. The dispute arose for the reason that the Income Tax Department has disallowed the claim of the appellant to treat royalty fee as expense. The learned ATIR in paragraph 16 of its order dated 17.04.2017 has discussed the issue and the reason for not allowing the royalty as expense. In para 17 the learned ATIR has held that *"The answer to points (i) and (ii) will be "NO" because prior to sale of trade mark, M/s Shan Food (Pvt) Ltd. was established and Mr. Sikander Sultan owned majority of shares in the Company"*. In para 18 the learned ATIR has held that *"So far the answer to point No. (iii) is concerned, the amount of sale of trademark and goodwill i.e. Rs.500/= and date of its sale and validity of subsequent registration from back date, sale of trade mark and goodwill to a family member Yusra Sultan, creation of M/s Shan Food (Pvt) Ltd., Trademark User Agreement date. All the aspects show that the whole drama was played just to evade tax"*. The said Order of ATIR was passed under the provisions of Income Tax Ordinance, 2001. The provisions of the Income Tax Ordinance, 2001 (A Central statute) has no direct bearing upon the provisions of the Sindh Sales Tax on Services Act, 2011 (A Provincial statute). Both the laws have different field of operation. The Income Tax Ordinance, 2001 levied Income Tax, whereas the Sindh Sales Tax on Services Act, 2011 levied sales tax on services. If under the Income Tax Laws the franchise fee/royalty was not treated as expense it does not mean that Sindh sales tax on services is not payable for the services acquired and the recipient of service is absolved from payment/deposit of tax. While levying sales tax on services it has to be seen whether any service listed in the Second Schedule of the Act has been provided/rendered or acquired. If the service as listed in the Second Schedule of the Act, 2011 has been provided/rendered or acquired the Sind sales tax on services is payable.

12. Now it has to be examined whether acquiring right to manufacture, produce, market and sell the products under the trademark "SHAN" against consideration is a service or not. Section 8 of Sales Tax on Services Act, 2011 provides that there shall be charged, levied and collected a tax known as sales tax on the value of taxable services at the rate specified in the schedule in which the taxable services is listed. Section 3 of the Act, 2011 provides that a taxable service is a service listed in the Second Schedule of the Act. Sub-section (2) of section 3 of Act, 2011 at the relevant tax periods provides that a service that is not provided by a registered person shall be treated as taxable service if the service is listed in the Second Schedule of the Act, 2011 and (a) is provided to a resident person: (b) by a non-resident person in the course of an economic activity, including in the commencement or termination of the activity. An explanation is added to the above sub-section, which provides that this sub-section deals with services provided by non-resident persons to residents persons [whether or not the said resident person is an end consumer of such services]. From the perusal of the above provisions of law it appears that the services mentioned in the Second Schedule of the Act whether provided by a resident person or a non- resident person is a taxable service.

Sub-section (46) of section 2 of the Act, 2011 defines 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 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*". The definition of franchise is very exhaustive. It deals almost all the aspect of franchise and royalty. The appellant has a trademark user agreement with Shan, UAE. Under clause 3 (a) of the Agreement Shan, UAE has granted a license to the appellant to manufacture, produce, market and sell the products under the trademark "SHAN", which belongs to Shan, UAE . Clause 3 (b) of the said Agreement provides that Shan, UAE passed on to the appellant formulae of products as well as their composition and ingredients, customer and market information/data including the knowhow,

technology, etc. The said clause further provides that Shan, UAE will do so in future from time to time as and when required for the purpose and fulfillment of the agreement. The rights provided to the appellant by Shan, UAE are covered by the phrase "*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*" provided in the definition of franchise. It is clear that the appellant has acquired the right to produce, manufacture, distribute and sell or trade under the name of "SHAN" and this process is covered by the definition "Franchise". Clause 15 of the said Agreement provides that the appellant shall pay to Shan, UAE an amount equal to the 5% of net sales (as per audited financial statements) for the financial year (fallowed by second part) as royalty/license fee in consideration of agreement. Sub-clause of clause 15 also provides for subsequent annual payments by 31st March of the following year. The said agreement also provides the mechanism in case the agreement is terminated before the end of the year. In view of the above discussion it is held that the services acquired by the appellant from Shan, UAE are covered under the definition of "Franchise Service" and the same is listed in the Second Schedule of the Act as Tariff heading 9823.0000 (Franchise Services) and by virtue of section 3 (2) of the Act, 2011 the same is a taxable service chargeable to Sindh Sales Tax on Services under section 8 of the Act, 2011. It is also held that in view of Trademark User Agreement between the appellant and Shan, UAE the appellant has received/acquired the services of franchise from outside Pakistan/non-resident.

13. The learned representative of the appellant argued that the expression "non-resident" has not been defined in the Act, 2011, Rules, 2011 and the Withholding Rules, 2014. Where the definition is not available in the statute the assistance can be taken from normal dictionaries. The expression "non-resident" was defined in the Oxford Advanced Learner's Dictionary, International Student's Ninth Edition, "as a person or a company not living or located permanently in a particular place or country". The expression "non-resident" was also defined in the Black's Law Dictionary, Tenth Edition "as someone who does not live within a particular jurisdiction". Admittedly franchiser M/s Shan, UAE is not available in Pakistan and based at UAE and for the purpose of Sindh Sales Tax on Services is a non-resident.

14. Mr. Adnan Mufti the learned representative of the appellant challenged that no assessment order can be passed under section 23 against a recipient of service and the assessment can only be passed against a registered service provider. It is true sub-section (1) of section 9 of the Act, 2011 fix the responsibility of payment of tax upon the registered person providing the service. However while arguing this point the learned representative ignored sub-section (2) of section 9 of Act, 2011, which provides that in case where a service is taxable by virtue of sub-section (2) of section 3 of the Act, the liability to pay the tax shall be on the person receiving service. In this case the service has been provided to appellant (resident person in terms of sub-section (73) of section 2 of the Act, 2011) by a non-resident person in terms of clause (a) and (b) of sub-section 2 of section 3 of the Act, 2011 read with explanation attached to the said sub-section. Furthermore sub-section (3) of section 9 provides that notwithstanding anything contained in sub-sections (1) and (2) {Board} may, by a notification in the official Gazette, specify the services or class of services in respect of which the liability to pay tax shall be on the person providing the taxable service, or the person receiving the taxable service or any other person. In this context the Board has framed The Sindh Sales Tax on Services Rules, 2011 in exercise of powers conferred on it under section 72 read with sections 5, 6, 9, 13, 26 and 75 of the Act, 2011. The relevant rule for payment of Sales Tax on franchise service is Rule 36 of Rules, 2011. Sub-rule (iv) of Rule 36 provides that in case where the franchiser and franchisee are both locally based, the liability to deposit the [tax on] franchise fee or royalty shall be upon the franchiser. [However, in case where the franchiser is based outside Pakistan, the liability to deposit the tax on franchise fee or royalty shall be upon the franchisee]; From the above discussion it appears that by implication of law the liability of deposit of tax was shifted upon the franchisee, the appellant in this case. Since the liability to deposit the tax was shifted upon the appellant (franchisee), section 23 of Act, 2011 can be competently invoked for assessment of tax against the appellant particularly in the circumstance where the appellant has deposited the Sindh sales tax on services for the tax periods July, 2013 to June, 2014 and for tax periods July, 2014 to June, 2015 made provisions of payment of royalty in its financial statements. Furthermore the learned representative of the appellant also claimed that provisions of the royalty amount/franchise fee is inclusive of

Sindh sales tax and the assessing officer while computing/determining the tax has given the benefit of the same to the appellant and reduced the tax liability from Rs. 45,367,320/=. To Rs.38,086,281/=.

15. Mr. Adnan also argued that according to SRB the tax on franchise services is to be levied on accrual basis and not on the basis of actual payment. Mr. Turab Ali in reply argued that clause (i) of sub section (2) of Section 17 of the Act provides that a taxable service shall be considered to have been provided in the tax period during which it was provided to the recipient and the tax is payable accordingly. Section 17 of Act, 2011 provides the time, manner and mode of payment. The law does not provides that the tax is payable on the basis of actual payment. Clauses (i) to (iii) of sub-section (2) of section 17 of Act, 2011 provides three eventualities in which the tax has become due and payable with the condition that whichever is earlier. The first eventually is that the service has been provided to the appellant in terms of Trademark User Agreement. In presence of Trademark User Agreement it cannot be disputed that the appellant has not acquired/received the franchise services. The tax is not payable on the basis of actual payment but is payable in the tax period during which the service was provided to the recipient. Since the Appellant has received the taxable services irrespective of actual payment of royalty/franchise fee the tax is payable within the tax period within which service was acquired/received.

16. Mr. Adnan also argued that the Trademark User Agreement was revoked and placed on record letter of the appellant dated 17.01.2017 addressed to Shan, UAE. On perusal it appears that the said letter is not a revocation letter but an information to Shan, UAE for holding the royalty payment due to dispute with FBR regarding FED/Royalty tax issue. Furthermore even if this letter is treated as revocation letter it will take effect from its date and not back dated for the tax periods in which the service was acquired/received and provision for payment of royalty has been made in the financial statement.

17. As far as the imposition of penalty is concerned the same can only be imposed if the depart is able to establish mensrea and willfulness on the part of the appellant. There is a genuine dispute between the department and the tax payer regarding the chargeability of tax on franchise service. In presence of a genuine dispute it cannot be said that the appellant has withhold the tax

without any cause and justification. Particularly in the background that the appellant has deposited a considerable amount of tax with exchequer for the previous tax periods. In view of the discussion it is held that the appellant is not liable to pay default surcharge and penalty if the principal tax amount is paid before 3oth June, 2018.

18. In view of the above discussion the appeal is dismissed.

The appeal is disposed of in the above terms. The copy of the order be provided to the authorized representative of the parties.

(Agha Kafeel Barik)
Technical Member

(Justice ® Nadeem Azhar Siddiqi)
Chairman

Karachi.
Dated: 04.06.2018

Copies supplied to:-

1. The Appellant through Authorized Representative.
2. The Assistant Commissioner, SRB, Karachi.

Copy for information to:-

3) The Commissioner (Appeals), SRB, Karachi.
4) Office copy
5) Guard file.

Certified to be True Copy

REGISTRAR
APPELLATE TRIBUNAL
SINDH REVENUE BOARD