





1. BRIEF COMMENTS ON THE JUDGEMENT PASSED BY THE HONOURABLE HIGH COURT OF SINDH DISMISSING THE CONSTITUTIONAL PETITIONS CHALLENGING THE VIRES OF SECTION 7E (DEEMED INCOME).

1. BACKGROUND

A tax on immovable properties having fair market value more than Rs 25 million held by resident persons, subject to certain exclusions, was levied vide the introduction of Section 7E of the Income Tax Ordinance 2001 ("ITO") through the Finance Act 2022. The tax rate prescribed was 20% on the amount equal to 5% of the fair market value of the immovable property. The same was also made effective retrospectively (from Tax Year 2022). Being aggrieved of this tax, Constitutional Petitions were filed challenging the vires of Section 7E before various High Courts all over the country. The Learned Division Bench of the Hon'ble Sindh High Court ("SHC") heard the matter at length and dismissed the petitions on 26th November 2022 vide a short order, whereafter detailed reasons were authored and released accordingly.

2. ARGUMENTS BY THE PETITIONERS' COUNSEL

The counsel for the Petitioners challenged the provisions of Section 7E of the ITO on the grounds that, inter-alia, the same was discriminatory, confiscatory, and therefore, ultra vires to the Constitution of Pakistan 1973 ("Constitution").

The Petitioners challenged that the impugned levy should have been levied through the Act of Parliament by following the procedure as contemplated under Article 70 of the Constitution. They argued, inter-alia, that tax can only be made when there is an earning potential; which lacked in the present facts and circumstances, that it also failed to pass the twin test regarding discrimination as settled by the Hon'ble Supreme Court of Pakistan ("SC") and India.

It was also argued that it imposes a tax on immovable property and is not a tax on deemed income. Moreover, the said tax has been retrospectively instead of being levied from the next tax year. Furthermore, the said tax is confiscatory as the taxpayers are not generating any income, notwithstanding holding of immovable properties, so as to pay tax on its deemed income.

Furthermore, the Petitioners stated that when the Finance Bill was sent to the Senate of Pakistan, a resolution was passed against this levy and that the advice of the senate must not be ignored.

They further contested that deemed income has some nexus with a business activity which is lacking in the present case, and that it amounts to double taxation as property tax is already levied by the provinces.

The petitioners also argued that the exclusion and exemptions provided in the Section 7E must have nexus with some policy objectives of the Government.

Moreover, an idle property was also being taxed and deemed as generating income, which therefore meant that there was no actual receipt of income / money. In other words, tax was being levied on fictional income.

3. ARGUMENTS BY THE RESPONDENTS' COUNSEL

The counsel for the Respondents contended that the concept of deemed income was not novel, and claimed that a number of cases passed by the superior courts had validated it. They further argued that the tax imposed was not on property but in fact it was on income which falls within the competence of the Federal Legislature under Entry 47 of the Fourth Schedule of the Constitution. The Respondents, therefore, argued that the said tax did not fall within Entry No. 50.

The Respondents, inter-alia, also argued that a tax on rental income (Section 15 of the ITO) is already in field and is being paid by the taxpayers, and so are various other taxes on property under the ITO. Moreover, as far as discrimination is concerned, the Respondents further argued that the exceptions that have been provided under Section 7E relate to different classes of persons that are otherwise enjoying exemptions and exceptions under the ITO. The Respondents also argued that the levy itself is a tax and within the competence of the Federal Legislature to introduce the same under Article 70 of the Constitution by way of a Money Bill.

As far as hardship to pay the tax or the inability to pay is concerned, this is not a ground for the tax to be declared ultra vires. The respondents also stated that the levy did not affect any fundamental rights nor was the property being forcefully acquired.

It was also argued that the tax had been levied to fulfil various obligations and functions of the State which required immediate taxation measures. It was not ultra vires as it is the prerogative of the legislature to choose a class of persons on whom the tax may be imposed or not,



and that there are provisions of presumptive incomes and presumptive taxes in the ITO therefore it was not necessary to have an actual taxable income for taxation purposes.

They also contested that various taxpayer had also availed the benefits of Foreign Assets Declaration Act, 2018 followed by an Ordinance of 2019 when benefits of the said legislation on property was availed. The respondents prayed for dismissal of the petitions.

4. ARGUMENTS BY THE LEARNED ASSISTANT ATTORNEY GENERAL OF PAKISTAN

The Learned Assistant Attorney General appeared on behalf of the Federation and contended that it was within the competence of the Federal legislature to tax any income from property and the provisions in question was not a tax itself on such property, and that the income in this matter is generated through the property, and that it falls within the competence of the Federal Legislature under Entry 47 of the Fourth Schedule to the Constitution.

He, therefore, prayed for the dismissal of the Petitions as well.

5. FINDINGS OF THE HON'BLE SINDH HIGH COURT

The SHC held as follows:

5.1. DISCRIMINATION:

That this argument was not only misconceived, but it also had no force or legs to stand on. It had been held by the SC as well as various judgments by various High Courts that the legislature has the competence to levy tax on different classes of persons and merely for the fact that someone is exempted from tax, it cannot always be pleaded that it is discriminatory in nature and is liable for being struck down. The SHC also stated that in order to strike down, according to Article 25 of the Constitution, it must be demonstrated that the said law was not based on intelligible criteria and does not have a nexus with the purpose of law. Therefore, the legislature is competent to classify persons or properties into different categories subject to different rates of tax.

The SHC further stated that the test of vice of discrimination was less rigorous and if there was uniformity within each group founded in intelligible differentia having a rational nexus with the object sought to be achieved by the law then the constitutional mandate that a law should not be discriminatory is fulfilled.

Furthermore, the classes of persons who have been granted exemptions from such levy are within the competence of the legislature as being classified separately. It further held that the classification was further classified and not generic in nature. For instance, original allottee of the capital assets (duly certified by allotment authorities) were granted exemption where the exception was only provided to the original allotment and not thereafter.

Hence, it was held that if the Legislature had classified persons/properties into different rates of taxation with reference to income or property then it would not be an inequality, nor would such classification be deemed to be unequal. The SHC placed reliance on the case of I A Sherwani reported as 1991 SCMR 1041, wherein the SC held that equal protection of law did not envisage that every citizen should be treated alike in all circumstances but in fact contemplates that persons similarly situated or similarly placed should be treated alike.

It was further held that reasonable exemption (up to Rs 25 million) has been provided to all taxpayers in respect of properties owned by them therefore of any merits and not tenable.

OUR COMMENTS:

The SHC in its findings concluded that the Petitioners are estopped from pleading discrimination due to a benefit in the shape of the general exemption for persons having capital assets worth upto PKR 25 million being available to them. In our view, such conclusion has attempted to repel the argument regarding the discrimination and would find interest should the matter be put forth in appeal before the Honourable Supreme Court of Pakistan.

5.2. CONFISCATORY NATURE OF LEVY:

The SHC held that there is no concept of invalidating a levy or tax merely on the ground that the taxpayer does not have any such capacity to pay tax. The SHC took reliance on the judgment passed by the SC in the case of Elahi Cotton which was decided by a five-member bench and held that taxing power is unlimited as long as it does not amount to confiscation and such imposition cannot be struck down just because the taxpayer is not in the capacity to pay. It further stated that it is a natural thing that while paying taxes there is always an element of hardship for a taxpayer in discharging the tax liability so created by the statute, but this neither makes it inevitable nor any ground supports it to be struck down. Therefore,



it cannot be declared as ultra vires to the Constitution on the ground that it is confiscatory in nature.

OUR COMMENTS:

In cases where the property was acquired at a time when its actual cost was low compared to the current prevailing fair market value, the levy of tax under Section 7E seems to be burdensome and confiscatory in nature especially the income of the taxpayer for the tax year is lower than the deemed income tax under Section 7E.

5.3. LEGISLATIVE COMPETENCE:

The SHC noted that deemed income is an approved concept of taxation and not dependent on the actual money/income received by the taxpayer like in case of rental property, the annual amount of rental property can be deemed irrespective of being rented or not. Moreover, it was held that the argument that this can only be levied by Provincial government is misconceived. The SHC has in effect held that Section 7E levies a tax on the income deemed to arise from the capital asset(s) mentioned in the said Section, subject to certain exceptions. Therefore, as per this judgment, Section 7E is not in pith and substance a tax on the capital value of immovable property.

It was further held that holding the property beyond the threshold is deemed to be generating income and should be levied. Deemed income is a fictional income concept and may not always be actual income, therefore, if the mentioned condition in the Act is satisfied then it is considered to be deemed income irrespective of the actual transaction. Whoever holds property is presumed to be having an income even if the owner receives income or possibility of receiving any income or neither exists, as fictions always conflict with reality but presumptions may prove to be true.

The argument on technical grounds regarding the inability of FBR to make arrangements regarding the collection mechanisms deserves to be decided by the Government.

If this fiscal statute is beneficial to the country as a whole, then the Individual interests cannot yield higher than the national interest.

OUR COMMENTS:

The design of Section 7E is such that it is in essence a tax on the fair market value of the immovable property, as the definition of capital asset contains exceptions that narrow the tax incidence down to the holding of immovable property. Moreover, an interesting point of law that may be deliberated upon (should this decision be appealed before the Supreme Court of Pakistan) is whether the Government can deem income arising from immovable property, whilst Section 15 (Income from Property) of the ITO still exists in the ITO. Section 15 stipulates that if rent is lower than annual fair market rent, then annual fair market rent will be deemed to be the rental income, however, even in that case, the property should have actually be let out.

DISCLAIMER

The judgment discussed in this document was recently announced by the honorable Sindh High Court. These comments are based on our understanding of tax law and past practices. These comments are provided for general use of public and should not be used for any specific transaction. We do not guarantee that these comments/interpretations will be acceptable by the tax department. This document is not and shall not be construed to be a legal opinion, legal assistance, a legal advice, or a financial advice for, inter-alia, investing, managing taxes, incorporating any legal entities. Tola & Tola does not assume, nor does it bear any responsibility, financial or otherwise, that can or may arise out of the use of this document by any individual or entity. Moreover, the laws (including Rules, Regulations, Acts and Ordinances) covered in this document are subject to changes, hence, it is recommended that the reader must refer to the actual text of the law being referred to in this document, and the actual text of any supplementary legislation (including any rules, by-laws, regulations, crossreferenced Acts or Ordinances) thereto which may not have been mentioned in the document. Tola & Tola also bears no responsibility to update this document for events and circumstances occurring on or after the date of this document.

Furthermore, we do not extend any sort of guarantee or indemnity, financial or otherwise, for the acceptance of the comments mentioned in this document by any statutory or non-statutory authority. Please feel free to provide your feedback for further improvements in the document. Should you have any queries in relation to this document, do not hesitate in contacting us.

Warm Regards,
TOLA & TOLA
info@tolaandtola.com
408, 4th Floor, Continental Trade Centre,
Block8,Clifton,Karachi,75600,Pakistan.