

SUPREME COURT OF PAKISTAN

(Appellate Jurisdiction)

PRESENT:

Justice Muhammad Ali Mazhar
Justice Irfan Saadat Khan
Justice Aqeel Ahmed Abbasi

CIVIL APPEAL NO.1137 OF 2018

*(Against the judgment dated 27.09.2017
passed by Peshawar High Court,
Peshawar in Sales Tax Reference
No.R.33/2011)*

M/s A.J Textile Mills Ltd.

...Appellant(s)

Versus

Commissioner, Regional Tax Office,
Sales Tax (Wing), Peshawar and another

...Respondent(s)

For the Appellant(s): Mr. Issac Ali Qazi, ASC

For the Respondent(s): Dr. Farhat Zafar, ASC

Assisted By: Ms. Zainab Bashir, Judicial Law Clerk

Date of Hearing: 22.06.2026

JUDGMENT

AQEEL AHMED ABBASI, J.- The instant Appeal, with the leave of the Court, has been filed against the impugned judgment dated 27.09.2017 passed by the Peshawar High Court, Peshawar (“**High Court**”) in STR No.33/2011 whereby, the High Court has set aside the judgment of the Appellate Tribunal Inland Revenue, Peshawar Bench, Peshawar dated 11.05.2010 and decided the questions of law formulated in **affirmative** against the appellant and in favour of the respondent No.1, while holding that the appellant was not entitled to deduct/ adjust the amount of input tax against the goods which have not been used in the taxable supplies as required under Section 8(1)(a) of the Sales Tax Act, 1990 (“**STA,1990**”).

2. Brief facts of the case as recorded by the High Court are that during an audit by DGRRA Lahore, it was observed that under Section 8(1) of the STA, 1990, a registered person is not entitled to reclaim or deduct input tax paid on goods unused or to be used for any purpose other than for the manufacture or production of taxable goods or for taxable supplies made or to be made by him. Contrary to this provision, appellant unlawfully adjusted an input tax of Rs. 3,181,649/- against output tax for raw material worth Rs. 20,566,082/- which was destroyed by fire as reported at Police station GAIE and reflected from daily diary/ report No.29 dated 15.05.2024, under which loss of Rs. 25 million apx. was statedly incurred, whereas an amount of input tax, credit in the sum of Rs. 3,181,649/- was claimed/adjusted against destroyed raw material from the output tax in respect of taxable supplies made during such period, despite the fact that such raw material was not used in manufacturing taxable goods whereas, claim of insurance amount i.e. of Rs. 20,675,000/- was also received. Consequently, a contravention case under Sections 3, 6, 7, 8, 11, 26, 33 and 34 of the STA, 1990, involving the claimed input tax credit of Rs. 3,181,649/- and an additional tax of Rs. 3,436,181/- was framed, leading to a Show Cause Notice dated 11.10.2005 issued by the Adjudicating Authority, which subsequently confirmed the allegations via Order-in-Original No. 07 of 2005 dated 03.12.2005. Aggrieved by this, the appellant filed a first appeal (Order-in-Appeal No. 109 of 2005) which was decided on 20.03.2006, leading the respondent to file a second appeal before the Appellate Tribunal Inland Revenue, Peshawar Bench, where the appeal filed by the appellant was accepted vide, order dated 11.05.2010, thereby the contravention report and show cause notice were vacated and both the orders of Revenue Authorities were set aside. Dissatisfied with the Tribunal's decision, the respondent No.1 filed Sales Tax Reference No.33/2011 before the Peshawar High Court, which set aside the judgment of the Appellate Tribunal Inland Revenue, Peshawar Bench, Peshawar dated 11.05.2010, and held that the appellant was not entitled to deduct/ adjust the amount of input tax against the goods which have not been used in the taxable supplies as required under Section 8(1)(a) of the STA, 1990, vide judgment dated 27.09.2017. Feeling aggrieved, the appellant challenged the same before this Court by filing a civil petition

for leave to appeal in which leave was granted vide order dated 02.10.2018 in the following terms: -

“Learned counsel submits that the question decided by the learned High Court is pending consideration by this Court pursuant to the leave granting order dated 29.5.2002 passed in CP No.450-L/2002. Accordingly, leave is granted to consider inter alia whether input tax paid on raw materials that have been destroyed in fire can be claimed in adjustment by the manufacturer-assessee against output tax, although such raw materials were not available for making taxable supplies.

...”

3. Learned counsel for the appellant has vehemently argued that the impugned judgment suffers from errors of both law and facts, rendering it unsustainable. It has been further argued by learned counsel that under the prevailing circumstances, recovering or disallowing input tax adjustment on raw material (cotton) purchased to be used in making taxable supplies, was unjustified as the remaining raw material which was saved from burning was utilized in the manufacturing of taxable supplies made through nine (9) sales tax invoices in the subsequent month of June 2024. Learned counsel submits that under Section 7(1) of the STA, 1990, entitlement to input tax adjustment matures upon the receipt of taxable goods for the purpose of making taxable supplies, without requiring a specific, itemized linkage to the final goods whereas, statute does not put any condition for claiming input tax adjustment on specific goods remaining intact, therefore the impugned order is legally misconceived. It has been contended that entitlement to input tax adjustment matures as soon as taxable goods are received by the registered person used or to be used for taxable supplies, therefore, demanding tax on goods that were destroyed/ burned prior to supply is in violation of the provision of Section 3 of the STA, 1990. According to learned counsel sales tax is an indirect tax which operates under a VAT regime where financial burden is designed to be passed along the supply chain to ultimate consumer, therefore demanding tax on raw material (cotton) destroyed by the fire before manufacture or supply of taxable goods is contrary to the scheme of STA, 1990. Learned counsel has submitted that penalizing the appellant for an accidental loss beyond its control subjects it to unfair double jeopardy by denying legitimate input tax adjustments after losing the underlying capital. While concluding his

arguments learned counsel has placed reliance in the judgment of Lahore High Court in the case of *M/s Mayfair Spinning v. Collector Sales Tax* (**PTCL 2002 CL 115**) which according to learned counsel has been duly affirmed by this Court in the case of *The Commissioner Inland Revenue, Legal Zone, Large Tax Payers Office, Lahore and Another v Messrs Mayfair Spinning Mills ltd* (**2025 SCMR 1**).

4. Conversely, learned counsel for the respondent has opposed the contentions put forth by the learned counsel for the appellant. According to learned counsel the learned High Court has rightly concluded that the appellant was not entitled to deduct/ adjust the amount of input tax against the goods which have not been used in the taxable supplies as required under Section 8(1)(a) of the STA, 1990. Learned counsel has further argued that the right to seek adjustment or refund is available only when the goods on which input tax was paid are used in further taxable activity for making taxable supplies, and not when those goods are destroyed. It has been prayed that instant Civil Appeal may be dismissed.

5. Heard the learned counsel for the parties, perused the record and the relevant provisions of the STA, 1990, and have also gone through the case law cited by the learned counsel for the appellant on the subject.

6. From perusal of the record and this case law cited hereinabove it has emerged that the legal issue involved in the instant case i.e. **whether input tax paid on raw materials that have been destroyed in fire can be claimed in adjustment by the manufacturer-assessee against output tax, although such raw materials were not available for making taxable supplies** is no longer *res integra* as it has been settled by this Court in the case of *The Commissioner Inland Revenue, Legal Zone, Large Tax Payers Office, Lahore and Another v Messrs Mayfair Spinning Mills ltd* (**2025 SCMR 1**) wherein, after examining the material facts and the relevant provisions of STA, 1990, relating to claim of input adjustment against output tax, this Court has been pleased to hold as under: -

“11. Upon a more introspective review of section 7 of the Sales Tax Act, we note that it provides a registered person with the opportunity to adjust input tax at the stage of determining his tax

liability, particularly in respect of taxable supplies made during the tax period. For a registered person to avail himself of the beneficial adjustment of input tax against output tax, section 7 as it was at the relevant time, mandates the following conditions:

Firstly, the input tax paid on purchases of inputs or raw materials must be intended for the purpose of making taxable supplies.

Secondly, the input tax paid must be for producing taxable supplies, irrespective of whether those taxable supplies have actually been made or are to be made in the future.

Thirdly, the input tax paid in a tax period is to be deducted from the output tax due for the same tax period and not against any future tax period.

Given the above essential conditions that must be fulfilled by a registered person to avail the beneficial adjustment facility provided under section 7 of the Sales Tax Act, we must first consider whether the respondent-taxpayer met these conditions, thereby entitling it to the claimed adjustment or refund.

First Condition - Purpose of Purchase

12.1. As for the first condition, there is no dispute between the parties that the cotton gin purchased by the respondent-taxpayer was an essential input/raw material for the production or manufacture of textiles-the final goods produced. Thus, the purchase of cotton gin, on which the input tax was paid by the respondent-taxpayer, qualifies to fulfil the first requirement; it was purchased as raw material for the purpose of manufacturing the final product, namely, textile products- the taxable supplies. This core issue, concerning the correlation between the "purpose" of purchasing the input/raw material and the making of the taxable supplies by the registered person, has been aptly addressed in the majority opinion and requires no further commentary, save for appreciation.

Second Condition - Taxable Supplies Made or to be Made

12.2. The words "taxable supplies made, or to be made" in section 7 do not limit the scope of the correlation between the purchase of the input/raw material and the actual manufacture or production of taxable supplies, that is the making of taxable supplies. Instead, they expressly expand its legal ambit to include input/raw materials intended for use in future for making taxable supplies. This explicit legislative intent to encompass future taxable supplies cannot be overlooked. In such circumstances, a registered person need not wait for the raw material, on which input tax has been paid, to be actually

consumed in the manufacturing process before availing the adjustment against output tax. This interpretation aligns with sound commercial and manufacturing reasoning, as highlighted in the majority opinion of the impugned judgment. Reading into and imposing a time-based restriction as to the use of the input/raw material, which was not provided by the legislature at that time, by way of interpretation would be contrary to settled principles of statutory interpretation. Indeed, there is no express requirement that the raw material, for which input tax is paid, must be actually used during the same tax period to qualify for adjustment. Denying such adjustment solely because the raw material has not been consumed during the same tax period contradicts the legislative intent. Thus, in the present case, the fact that the raw material, on which input tax had been paid, was not fully consumed during the tax period or was damaged, cannot, on its own, be a reason to deny the adjustment of input tax against output tax to the respondent-taxpayer, provided that the respondent taxpayer fulfils the other conditions stipulated in section 7 of the Sales Tax Act...

Objection of the Tax Authority to the Refund Claim

14. As for the objection raised by the appellant-tax authority regarding the claim of respondent-taxpayer being contrary to the mandate of section 8 of the Sales Tax Act, we find that the said provision does not apply to the circumstances of the present case. Section 8 of the Sales Tax Act, at the relevant time, read as follows:

8. Tax credit not allowed.--(1) Notwithstanding anything contained in this Act, a registered person shall not be entitled to reclaim or deduct input tax paid on

(a) the goods used or to be used for any purpose other than for taxable supplies made or to be made by him;

(b) any other goods which the Federal Government may, by a notification in the official Gazette, specify.

(2) If a registered person deals in taxable and non-taxable supplies, he can reclaim only such proportion of the input tax as is attributable to taxable supplies in such manner as may be specified by the Board.

(3) No person other than a registered person shall make any deduction or reclaim input tax in respect of taxable supplies made or to be made by him.

(4) No person engaged in taxable activity specified in clause (d) of subsection (2) of section 3, section 3A and section 3AA shall make any deduction or reclaim input tax, nor shall this tax

be creditable as input tax for the taxable activity of any other registered person.

A careful reading of the above provision suggests that section 8 only prohibits the claim, credit or deduction of input tax on input/raw materials that were either never intended for use in making taxable supplies or were actually used for purposes other than making taxable supplies by a registered person. The loss of input/raw materials through fire, as in the present case, does not fall within the scope of "used or to be used for any purpose other than for taxable supplies made or to be made", as stipulated in section 8. Loss of goods due to damage does not equate to "use". Therefore, section 8(1)(a) does not apply to cases where input/raw materials have been lost through fire. Moreover, as we are informed, no notification under section 8(1)(b) related to goods lost due to damage or fire has ever been issued. Even otherwise, section 8(1)(b) permits the exclusion of specific input goods from the scope of section 7 of the Sales Tax Act, requiring a clear identification of such goods or classes of goods, which, as we are informed, has never included damaged cotton-gin. Accordingly, the objection raised by the appellant-tax authority against the claim of the respondent-taxpayer is rejected."

7. We have made the extensive reproduction of the relevant paras of the above cited judgment of this Court to show that the facts and the law points involved in instant case are similar to the facts and the legal issue decided in the above cited judgment. Under the scheme of STA, 1990 in terms of Section 7, a registered person is required to establish firstly, that the input tax paid on purchases of inputs or raw materials must be intended for the purpose of making taxable supplies, Secondly, that the input tax paid must be for producing taxable supplies, irrespective of whether those taxable supplies have actually been made or are to be made in the future and thirdly, that the input tax paid in a tax period is to be deducted from the output tax due for the same tax period and not against any future tax period. On minute examination of the facts in the instant case, it appears that appellant has met all above conditions, whereas, the respondent No.1 has not disputed this factual aspect of the matter and has declined the claim of input adjustment while referring to provisions of Section 8 of STA,1990 which only prohibits the claim, credit, or deduction of input tax on input/raw materials that were either never intended for the use in making taxable supplies or actually used for the purposes other than making taxable supplies by a registered person. Whereas,

the destruction of raw material through fire as in the present case, does not fall within the scope of used or to be used for any purpose other than for taxable supplies made or to be made as stipulated in Section 8 of STA, 1990. Consequently, the loss of goods due to damage or where the raw material has been lost through fire is not covered under Section 8 (1) (a) of the STA, 1990. Accordingly, the question formulated in the leave granting order is answered in the **Affirmative**.

8. In light of the dictum laid down in the aforementioned precedent, the ratio of which is fully applicable to the facts of the instant case, instant appeal was allowed vide our short order dated 22.06.2026 in the following terms: -

“For reasons to be recorded later, this appeal is allowed; as a consequence, the impugned judgment is set aside and the judgment of the learned Appellate Tribunal Inland Revenue, Peshawar, is restored”

Above are the reasons for such short order.

Judge

Judge

ISLAMABAD
22nd June, 2026
"Approved for Reporting"
Zainab, Law Clerk/-

Judge