

SUPREME COURT OF PAKISTAN

(Appellate Jurisdiction)

Present:

Justice Irfan Saadat Khan
Justice Aqeel Ahmed Abbasi
Justice Shakeel Ahmad

CIVIL APPEAL NO.1468 OF 2018

*(Against the judgment dated 23.06.2014
passed by the Lahore High Court, Lahore,
in PTR No.237/2013)*

The Commissioner Inland Revenue

...Appellant(s)

VERSUS

M/s MCB Bank Ltd

...Respondent(s)

For the Appellant(s): Ms. Asma Hamid, ASC

For the Respondent(s): Mr. Salman Aslam Butt, ASC
Mr. Muhammad Shoaib Rashid, ASC

Date of Hearing: 08.07.2026

JUDGMENT

AQEEL AHMED ABBASI, J. – Instant civil appeal with the leave of this Court has been filed against the judgment dated 23.06.2014 passed by the Division Bench of Lahore High Court, Lahore ("**High Court**") in PTR No.237/2013 whereby the petition filed by the respondent, MCB Bank Ltd. was allowed.

2. Brief facts of the case as recorded by the Lahore High Court, Lahore are that the respondent, a listed banking company, had established a Pension Fund (Defined Benefit Plan) through a Trust Deed for the benefit of its employees. Income Tax Ordinance, 2001 ("**ITO, 2001**") under Section 32(2) requires that the method of accounting for a company to account for income interchangeable to tax under the head "Income from Business" shall be on accrual basis. Rule 32(2) of the Income Tax Rules, 2002 requires that the books of an account of a company to be maintained in accordance with the International Accounting Standards ("**IAS**"). Under IAS-19, it is required that a qualified chartered actuary computes present value of the assets and liabilities of the Pension Fund every year which results in either a surplus or a deficit. The surplus conventionally arises where

assets exceed the liability. The present value is determined on the basis of estimated annual increments etc. The surplus was recorded as income in the financial statement/ books of the respondent bank and the deficit appeared as expense. Applying this method of accounting the financial statement of the respondent bank reflected the surplus as income for the Tax Year 2011. However, the said "surplus" or "reversal of provision for approved Pension Fund" was not offered for tax by the respondent bank in the income tax return on the basis of Rule 4, Part-II of the Sixth Schedule to the ITO, 2001, which requires that unless the said surplus is actually repaid to the respondent bank, it shall not be deemed to be the income of the respondent bank. Rejecting the claim of the respondent bank, the Additional Commissioner amended the return vide order dated 28.02.2013 under Section 122(5A) of the ITO, 2001. The said amendment was upheld by the Commissioner (Appeals) on 10.05.2013 and affirmed by the Appellate Tribunal Inland Revenue ("**ATIR**") vide order dated 24.06.2013. Feeling aggrieved, the respondent bank filed a Reference Application (PTR No.237/2013) under Section 133(4) of the ITO, 2001 before the Lahore High Court, Lahore against the order of the ATIR dated 24.06.2013 passed in I.T.A No.846/LB/2011 which was allowed vide impugned judgment dated 23.06.2014 and the question of law formulated was answered in favour of the respondent bank. Feeling dissatisfied with such judgment, the appellant filed a civil petition for leave to appeal, which was granted vide order dated 28.11.2018 in the following terms: -

"Having heard learned counsel for the respective parties, we are inclined to grant leave to appeal to, inter alia, consider the questions identified in the order of 15.10.2018 and the following questions:

1. Whether in the facts and circumstances of the case, the one unit/basket concept as developed by the various judgments of this Court in relation to the insurance business/companies (including, but not limited to Commissioner of Income Tax v. Alpha Insurance Co. Ltd. and another PLD 1981 SC 293, Central Insurance Co. and others v. Central Board of Revenue and others 1993 SCMR 1232 and EFU Insurance Co. Ltd. Federation of Pakistan and others PLD 1997 SC 700) is applicable in relation to banking companies in the context of s. 100A read with the Seventh Schedule to the Income Tax Ordinance, 2001 ("2001 Ordinance") and if so, in what manner?

2. Whether, in the facts and circumstances of the case, the provisions of Part-II of the Sixth Schedule to the 2001 Ordinance, being special provisions dealing (among others) with an 'approved superannuation Fund', and in particular the use of the term "repaid" therein, are applicable to banking companies, especially, inter alia, in view of paragraph 9 of the Seventh Schedule?"

3. Learned counsel for the appellant has argued that the impugned judgment passed by the High Court is contrary to the facts and the law attracted in the instant case as according to learned counsel the income of a banking company has to be taxed in terms of Section 100A read with Seventh Schedule to the ITO, 2001 which provides a separate mechanism for computation of income ("income from business") on accrual basis, whereas, reference to Rule 4, Part-II of the Sixth Schedule to the banking company is misconceived, as it is general and applicable to all employers (individuals, AOPs and companies alike). According to learned counsel the High Court has misinterpreted the term "repaid" used in Rule 4, Part-II of the Sixth Schedule to mean actual repayment or payback. Learned counsel further argued that the High Court has disregarded the settled principle that special law meant for banking companies under the Seventh Schedule to the ITO, 2001 takes preference over the general provisions under the ITO, 2001 including Rule 4, Part-II of the Sixth Schedule. The principle of application of special provisions over general provisions is well settled in various judgments of this Court and High Court(s) including M/s Central Insurance Co. and others vs. The Central Board of Revenue, Islamabad and others (1993 PTD 766), Commissioner (Legal) Inland Revenue vs. M/s EFU General Insurance Ltd. (2011 PTD 2042), Commissioner of Income Tax vs. Habib Insurance Co. Ltd (1975 PTD 234) and M/s Habib Insurance Co. Ltd. and another vs. Commissioner of Income Tax Central, Karachi (1990 PTD 196). Learned counsel submits that in the case of EFU *supra* it has been held that income of an entity governed by a special schedule is computed as a single block within that schedule, whereas, special schedule ousts the general provisions of the ITO, 2001. Learned counsel has referred to provisions of Section 32 (2) which according to learned counsel provides that a banking company must account on accrual basis i.e. income is derived when due and not when received. While concluding his submissions, learned counsel for the appellant has submitted that Rule 9 of Seventh Schedule only admits an outside provision *mutatis mutandis* when the provisions of the ITO, 2001 have not specifically dealt with the matter, however, instant case can be dealt with income from other sources under Rules 1 and 6. It has been prayed that the impugned judgment dated 23.06.2017 may be set aside and the questions as formulated in the leave granting order dated

28.11.2018 may be answered in favour of the appellant and against the respondent bank.

4. Conversely learned counsel for the respondent bank has vehemently controverted the submissions made by the learned counsel for the appellant and has supported the judgment passed by the High Court which according to learned counsel for the respondent bank is based on correct appraisal of facts and law applicable thereto. According to learned counsel for the respondent, the method of accounting adopted by the respondent bank for the tax year under the dispute is the same which has been accepted by the department for several years, and prior to Tax Year 2011, the department never raised any objection in this regard, whereas, no reason whatsoever has been assigned by the department to deviate from the long-standing past practice. It has been further contended by learned counsel for the respondent that in terms of Section 32, taxpayers are permitted to compute income in accordance with the accounting method regularly employed by them, which provides an exception to the computation rules under Section 17 of the ITO, 2001. According to learned counsel, the respondent bank was fully justified in adopting a hybrid method of accounting that had been regularly used as a long-standing consistent method of accounting which has been duly accepted by the department, therefore, any deviation for such long-standing, consistent method of accounting without assigning any cogent reasons and through misinterpretation of the relevant provisions of Rule 4, Part-II of the Sixth Schedule to the ITO, 2001. The assessing officer has misdirected himself by holding that a banking company required to furnish accounts on accrual basis i.e. income is derived when due and not when received, however, failed to appreciate the application of the relevant provisions relating to taxability of approved superannuation Funds (Pension Funds) under Part-II of the Sixth Schedule to the ITO, 2001. Per learned counsel, the Rule 4 under Part-II of the Sixth Schedule to the ITO, 2001 provides that where any contribution to the Pension Fund by an employer, including interest thereon is **repaid** to the employer, the amount so repaid is deemed for the purposes of tax to be the income of the employer. In other words, according to learned counsel, a surplus amount is deemed to be the income of a taxpayer for the purposes of tax only when it is repaid to the employer which signifies the word "repaid" that is actual repayment

or payback, therefore, falls under the scheme of cash-basis accounting and not covered under the scheme of accrual basis accounting. It has been further contended by learned counsel for the respondent that in terms of Rule 9 of the Seventh Schedule to the ITO, 2001, the provisions of the ordinance not mentioned in the Seventh Schedule shall apply *mutatis mutandis* to the banking company, which means that the applicability of any other provision of the ordinance to the Seventh Schedule will also include all the necessary changes required to make the said provisions of the ordinance functional under the law. While concluding his submissions, learned counsel for the respondent has specifically relied upon the reasoning as contained in paras 8 to 11 of the impugned judgment passed by the High Court which, according to learned counsel is based on correct appreciation of facts of the instant case and the law applicable thereto, which according to learned counsel is unexceptional, therefore, the Civil Appeal, having no merits, is liable to be dismissed.

5. Heard the learned counsel for the parties, perused the record and have also gone through the impugned judgment passed by the High Court alongwith order of the ATIR for below with their assistance. The controversy as reflected from the question of law pressed before the High Court and the questions formulated by this Court through Leave Granting Order dated 28.11.2018 relates to applying the method of accounting for the purposes of computing "present value" of the assets and liabilities of the Pension Fund established by the respondent bank through a trust deed for the benefit of its employees. The "present value" is determined on the basis of estimated future return on assets, age of retirement, remaining service of the employees and estimated annual increments, etc. Section 32(2) of the ITO, 2001 requires that the method of accounting for a company to account for income chargeable to tax under the head "Income from Business" shall be on accrual basis, whereas, Rule 32(2) of the Income Tax Rules, 2002 requires that the books of account of a company shall be maintained in accordance with IAS. IAS-19 requires that a qualified chartered actuary computes "present value" of the assets and liabilities of the Pension Fund every year, which results in either "surplus" or a "deficit". The "surplus" is recorded in the income of financial statement/ books of account maintained by the respondent bank and "deficit" appears as expense while applying this method of

accounting, the financial statement of the respondent bank reflected the "surplus" as income for the Tax Year 2011. However, the said "surplus" (reversal of provision for approved Pension Fund) was not offered for tax by the respondent bank in the Income Tax Return for Tax Year 2011 on the basis of Rule 4, Part-II of the Sixth Schedule to the ITO, 2001 which requires that unless the said "surplus" is actually **repaid** to the respondent bank, which shall not be deemed as income of the respondent bank. The above said treatment by the respondent bank in its financial statement/ books of account was not approved by the appellant department up to the forum of ATIR on the grounds that case of the respondent bank is covered under Rule 1 of the Seventh Schedule to the ITO, 2001 which, according to the appellant department, being a special law tailored for the banking companies, takes preference over the general provisions under the ITO, 2001, including Rule 4, Part-II of the Sixth Schedule to the ITO, 2001. According to the appellant department, that Seventh Schedule to the ITO, 2001 draw its substantive powers under Section 100A of the ITO, 2001, whereas, Rules 6 and 8 of the Seventh Schedule to the ITO, 2001 also supports the application of the aforesaid provisions in the case of respondent bank.

6. In order to resolve the conflicting versions of the appellant department and the respondent bank in the instant case, we will examine the scope and application of the provisions of Sections 32 and 100A, Rule 4 Part-II of the Sixth Schedule and Rule 9 of the Seventh Schedule to the ITO, 2001, which have been reproduced hereunder for the sake of brevity and ready reference: -

"SECTION-32

Method of accounting. — (1) Subject to this Ordinance, a person's income chargeable to tax shall be computed in accordance with the method of accounting regularly employed by such person.

(2) Subject to sub-section (3), a company shall account for income chargeable to tax under the head "Income from Business" on an accrual basis, while other persons may account for such income on a cash or accrual basis.

(3) The [Board] may prescribe that any class of persons shall account for income chargeable to tax under the head "Income from Business" on a cash or accrual basis.

(4) A person may apply, in writing, for a change in the person's method of accounting and the Commissioner may, by [order] in writing, approve such an application but only if satisfied that the change is necessary to clearly reflect the person's income chargeable to tax under the head "Income from Business".

(5) If a person's method of accounting has changed, the person shall make adjustments to items of income, deduction, or credit, or to any other items affected by the change so that no item is omitted and no item is taken into account more than once.

CHAPTER VII, PART-II

100A. Special provisions relating to banking business. —

(1) Subject to subsection (2), the income, profits and gains of any banking company as defined in clause (7) of section 2 and tax payable thereon shall be computed in accordance with the rules in the Seventh Schedule.

(2) Sub-section (1) shall apply to the profits and gains of the banking companies relevant to tax year 2009 and onwards.

(3) Notwithstanding anything contained in sub-section (1), income, profits and gains and tax payable thereon shall be computed subject to the limitations and provisions contained in Chapters VII and VIII.]

SIXTH SCHEDULE, PART-II (APPROVED SUPERANNUATION FUNDS)

4. Contributions by employer, when deemed to be his income. — Where any contributions by an employer (including the interest thereon, if any), are repaid to the employer, the amount so repaid shall be deemed for the purpose of tax to be the income of the employer of the income year in which it is so repaid.

SEVENTH SCHEDULE (RULES FOR THE COMPUTATION OF THE PROFITS AND GAINS OF A BANKING COMPANY AND TAX PAYABLE THEREON)

9. Provision of Ordinance to apply— The provisions of the Ordinance not specifically dealt with in the aforesaid rules shall apply, mutatis mutandis, to the banking company”.

7. From perusal of section 32 of the ITO, 2001 it has been observed that broad guidelines have been provided for a tax-payer to adopt method of accounting for the purposes of computation of a person's income chargeable to tax under the ITO, 2001, whereas it further mandates that subject to this ordinance, a person's income chargeable to tax shall be computed in accordance with the method of accounting regularly employed by such person. It further provides that in case of a company, the income chargeable to tax under the head “income from business” the accounts shall be maintained on accrual basis, while other persons may account for such income on cash or accrual basis. The law further mandates that the method of accounting so maintained shall be regularly employed by such person and in case any person wants to change the method of accounting, shall make an application to the commissioner in writing and if such change in the method of accounting is approved, such person is required to make adjustments to the items of income, deduction, or credit accordingly.

In a nutshell Section 32 of ITO, 2001, primarily authorizes a taxpayer to adopt a recognized method of accounting either on cash or accrual basis, however, in consonance with the provisions of the ITO, 2001 relating to computation of income under the head "income from business", in respect of a company or person(s) defined under Section 80 of the ITO, 2001. In the case in hand the respondent, a banking company has been furnishing its tax returns through a regularly employed method while following the International Accounting Standards (IAS), whereas, for the purposes of computation of profits and gains of a banking company and tax payable thereon, reference to Rule 1 of the Seventh Schedule to the ITO, 2001 has been made according to which income of a banking company shall be taken to be the income disclosed in the annual accounts required to be furnished to the State Bank of Pakistan. Under the said Rule the account of the respondent bank, prepared under IAS-19 on accrual basis accounting for Tax Year 2011 reflects the amount of "surplus" or "reversal of provision for approved pension Fund" as the income of the respondent bank. The Seventh schedule to the ITO, 2001 deals with the banking company, however, it specifically provides for taxability for approved superannuation Funds (pension Funds) under Part II of the Sixth schedule to the ITO, 2001. Similarly, Rule 4 thereunder provides that where any contribution to the pension Fund by an employer, including interest thereon is **repaid** to the employer, the amount so repaid is deemed for the purposes of tax to be the income of the employer. As per plain language of hereinabove provision relating to pension Funds, and the term **repaid** used therein, the surplus amount is deemed to be the income of the taxpayer only **when it is actually repaid to the employer**, which falls under the scheme of cash basis accounting and not under the scheme of accrual basis accounting. The appellant department, however, did not accept such financial statement submitted by the respondent bank for Tax Year 2011 simply on the grounds that since the respondent bank has prepared and furnished account under IAS-19 on accrual basis accounting to the State Bank of Pakistan, therefore, they cannot be allowed to change the existing accrual basis of accounting in respect of surplus arising in pension Fund to cash basis accounting. Another objection in this regard was raised by the department that the computation of profits and gains of a banking company and the tax payable thereon has to be calculated

in terms of Section 100A read with Seventh Schedule to the ITO, 2001 which provides a separate mechanism for computation of income ("income from business") on accrual basis. Both these objections raised by the tax department in the case of the respondent bank are misconceived in fact and law. It is by now well-settled that for the purposes of furnishing financial statements, a banking company can adopt a hybrid method of accounting for the purposes of computation of income and tax thereon under the head "income from business" and the tax authorities cannot discard or deviate from a regularly employed method of accounting by an assessee which was duly accepted by the tax authorities unless they can demonstrate that such practice is contrary to statutory provisions of law. In the case of Commissioner Income Tax v. Habib Bank Limited and ANZ Grindlays Bank PLC (2015 PTD 619 SC) this Court, **while recognizing the hybrid accounting method** consistently used by the bank under Section 32 of the ITO, 2001, has held as under: -

"3. The case of the respondent-Banks is that under section 32 of the Ordinance, the respondent-Banks being assesses are empowered to adopt the method of accounting of their choosing..."

4. Considering the provisions of sections 17 and 32 of the Ordinance, reproduced above, we cannot help but notice that section 32 provides an exception to the computation of income set out in section 17, which obviously includes section 17(1) (a). In these circumstances, the impugned judgments rendered by the High Court have in our opinion correctly held that the respondent-Banks were justified in adopting the method of accounting which was hybrid and had been consistently used by the respondent-Banks since long"

Similarly, in the case of Deputy Commissioner of Income Tax v. National Bank of Pakistan (2019 SCMR 1011) it has been held as under: -

"12. Having considered the case law, in our view two broad propositions emerge in relation to the 1979 Ordinance... Firstly, as a matter of law, an assessee was not limited to using either the accrual or the receipt basis of accounting. It was, in law, permissible to use the 'hybrid' system of accounting by mixing and merging elements from the other two systems. This was a question of law, and must be regarded as having been answered and settled accordingly."

"14. ...It suffices to accept that there was a past practice that interest income offered on receipt basis was accepted as such by

the Department... No reason was given by the Department to depart from the stated practice, other than the change in view of the Appellate Tribunal. However, that change in view was patently incorrect since we have held that it has long been accepted, and also stands affirmed by this Court, that as a matter of law the 'hybrid' system of accounting could be adopted under the 1979 Ordinance... It follows that the Department was wrong in refusing to accept interest income offered on receipt basis in respect of the assessment years at hand..."

8. Keeping in view the hereinabove settled legal position relating to method of accounting to be adopted under Section 32 of ITO, 2001 by a company (banking company), we may now examine the scope and application of the relevant provisions of Sixth and Seventh schedule to the ITO, 2001 applicable to the peculiar facts of the instant case. The dispute in the instant matter relates to computation of surplus of superannuation Funds (Pension Funds) to be offered for taxation either on accrual basis or cash basis or a duly recognized **hybrid method of accounting**. This aspect of the matter has been ably dealt with in detail by the High Court after examining the facts and the relevant provisions of the ITO, 2001 relating to method of accounting and the computation of surplus of superannuation Funds (Pension Funds) in the case of a banking company in paras No. 8, 10 and 11 of the impugned judgment, wherein, it has been concluded by the High Court that since there is no specific provision dealing with the issue of computation of surplus of superannuation Funds (Pension Funds) in the case of a banking company available in seventh schedule to the ITO, 2001, therefore, a resort has to be made to a specific provision provided under Rule 4 of part II of the Sixth schedule, ITO, 2001 in this regard according to which in respect of pension Fund the accounting methodology is on cash basis. This view finds favour from a specific provision provided under Rule 9 of the Seventh schedule to the ITO, 2001 which states that "*The provisions of the Ordinance not specifically dealt with in the aforesaid rules shall apply, mutatis mutandis, to the **banking company***". Moreover, the harmonious construction is a well-recognized principle of interpretation of statutes in number of judgments of this Court including Waqar Zafar Bakhtawari and 6 others vs. Haji Mazhar Hussain Shah and others (PLD 2018 SC 81) wherein, it has been held as under:-

"9. Heard. It may be necessary to mention here that the portions of Section 17 ibid which have been omitted from reproduction are the grounds for eviction of tenant, such as, default in the payment of rent, reconstruction, causing damage to the rented property, nuisance, personal requirement, etc. It is settled that while interpreting the law, a specific provision of any statute, which is independent in nature, cannot and should not ordinarily be held to be redundant, especially on the touchstone of another independent provision of the same statute; rather all possible efforts should be made to apply and adhere to the rules of purposive and harmonious construction, so that the allegedly conflicting provisions should be reconciled and saved..."

Further reliance can be placed upon *D.G. Khan Cement Company Ltd. and others vs. Federation of Pakistan and others* (2004 SCMR 456), *Collector of Sales Tax and Central Excise (Enforcement) and another vs. Mega Tech (Pvt.) Ltd.* (2005 S C M R 1166), *Mirza Shaukat Baig and others vs. Shahid Jamil and others* (PLD 2005 SC 530) and *Director, Directorate-General of Intelligence and Investigation and others vs. Messrs Al-Faiz Industries (Pvt.) Limited and others* (2006 SCMR 129).

9. Admittedly, under the Seventh Schedule, there is no specific provision provided for such purpose, whereas, as per Rule 4 of the part II of the Sixth Schedule to the ITO, 2001 the legislature has provided a specific provision for the purpose of computation of surplus of superannuation Funds (Pension Funds) by an employer according to which any contribution by an employer (including the interest thereon, if any), are **repaid to the employer**, the amount so repaid shall be deemed for the purpose of tax to be the income of the employer of the income year in which it is so repaid. This specific provision authorizes a banking company to adopt a method of accounting on cash basis in respect of the amount of surplus of superannuation Funds (Pension Funds), shall be deemed for the purpose of tax to be the income of employer of the income year in which it is actually repaid. Such treatment of offering the aforesaid amount for taxation on receipt-basis is in line with the above-mentioned provisions of law which method of accounting was regularly employed by the respondent bank and was duly accepted by the tax authorities. Therefore, the tax authorities otherwise could not either in law, or in view of acceptance of regularly employed method of accounting by the taxpayer discard such accounting method for the purposes of taxation, nor could

deviate from the past practice of acceptance of regularly employed method of accounting by the taxpayer.

10. Keeping in view hereinabove discussion on facts and law applicable to the instant case, we will now respond to the first question of law formulated in the leave granting order dated 28.11.2018. On examination of such question, we find that the rigid "one unit/basket" concept developed in insurance jurisprudence (such as the *Alpha Insurance* and *Central Insurance* cases) cannot be automatically transplanted to banking companies in a manner that defeats specific statutory linkages. While commercial accounting (IAS-19) mandates recording defined-benefit Fund surpluses on an accrual basis for transparency, financial accounting guidelines do not dictate taxability. As established in fiscal jurisprudence, tax laws create their own artificial boundaries for income; income under commercial GAAP is merely a book entry, whereas income under the ITO, 2001 requires a specific statutory charging event. Unlike the insurance framework, the Seventh Schedule governing banking companies explicitly contains **Rule 9**, which acts as an operational bridge: "*The provisions of the Ordinance not specifically dealt with in the aforesaid rules shall apply, mutatis mutandis, to the banking company.*" This rule expressly contemplates and permits importing external, specific provisions from the Ordinance and its schedules where the Seventh Schedule remains silent. Accordingly, the first question is answered in **Negative**.

11. Adverting to the second question, Part-II of the Sixth Schedule to the ITO, 2001 provides a dedicated, special regime for approved superannuation and pension Funds. Specifically, **Rule 4** dictates that employer contributions or surpluses are deemed to be the income of the employer *only in the income year in which they are so repaid*. The statutory term "repaid" establishes a strict condition precedent, requiring an actual cash-flow event, a physical payback or transfer of Funds back to the employer's operational accounts rather than a notional, paper-based actuarial surplus calculated under IAS-19. Applying the principle of *generalia specialibus non derogant*, this subject-specific statutory rule (pension Fund taxability) prevails over general heads of banking income. Because the Seventh Schedule does not contain an independent mechanism to tax actuarial pension surpluses, **Rule 9** successfully draws in Rule 4 of Part-II of the Sixth

Schedule to the ITO, 2001, *mutatis mutandis*, adapting its cash-basis realization requirement to function smoothly within the banking tax regime. Accordingly, the second question is answered in **Affirmative**.

12. In view of the hereinabove facts and circumstances of this case, the instant Civil Appeal was dismissed vide our short order dated 08.07.2026 and above are the reasons for such short order.

Judge

ISLAMABAD
08.07.2026
"Approved for Reporting"
Zainab Bashir/JLC