

Tax Avoidance Under Section 109: Supreme Court Says Incidental Tax Benefit Is Not Enough

The Supreme Court dismissed 20 Revenue appeals, holding that a genuine transaction cannot be re-characterised under section 109 merely because it produces a tax benefit; avoidance or reduction of tax must be a main purpose of the transaction.

Supreme Court of Pakistan judgment analysis
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Lead case: Commissioner Inland Revenue, Karachi v EFU General Insurance Limited and connected insurance companies

Proceedings: Twenty connected civil appeals concerning insurance-company share transactions

Court: Supreme Court of Pakistan | Detailed reasons issued 16 September 2026

Bench: Chief Justice Yahya Afridi, Justice Muhammad Shafi Siddiqui and Justice Miangul Hassan Aurangzeb

Result: All Revenue appeals dismissed; section 109 main-purpose requirement not established

The ruling in one sentence

The Supreme Court of Pakistan has held that a genuine commercial transaction cannot be re-characterised as a tax avoidance scheme under section 109 of the Income Tax Ordinance, 2001 merely because it produces a tax benefit; avoidance or reduction of tax must be a main purpose of entering into the transaction, not an incidental or consequential result.

The judgment decides 20 connected civil appeals brought by the Commissioner Inland Revenue against EFU General Insurance Limited, EFU Life Assurance Limited, Century Insurance Company Limited, Central Insurance Company Limited, Shaheen Insurance Company Limited, Habib Insurance Company Limited, State Life Insurance Corporation, Allianz EFU Health Insurance Limited and IGI Insurance Company Limited.

Justice Muhammad Shafi Siddiqui authored the reasons for a three-member bench comprising Chief Justice Yahya Afridi, Justice Muhammad Shafi Siddiqui and Justice Miangul Hassan Aurangzeb. The appeals were dismissed through short orders dated 16 June 2026. The detailed reasons were issued on 16 September 2026 and approved for reporting.

Why the insurance companies sold and repurchased shares

The insurance companies held substantial portfolios of shares in associated listed companies. Over time, the market value of those shares increased considerably.

The applicable insurance accounting framework required investments classified as available for sale to be shown at the lower of cost or market value. Where market value rose above the original acquisition cost, the companies could not simply revalue the shares upward and recognise that increase in their accounts.

To capture the higher market value, the companies sold the shares and shortly thereafter repurchased them. The sales realised the difference between the original cost and the current market value as capital gain. The repurchased shares then appeared in the accounts at the new acquisition cost.

The companies maintained that the purpose was to reflect the long-suppressed market value in their books, strengthen their balance sheets and improve liquidity. The transactions were recorded in the accounts and returns, and their genuineness was not disputed by the Revenue.

For Tax Year 2007, the companies claimed exemption for the realised capital gains under Rule 6A of the Fourth Schedule to the Income Tax Ordinance, 2001. Rule 6A had been inserted through the Finance Act, 2005 and was later omitted by the Finance Act, 2017. It remained operative for the tax years involved in the appeals.

How the Revenue tried to re-characterise the transactions

The returns initially resulted in deemed assessments. The Taxation Officer considered those assessments erroneous and prejudicial to Revenue and initiated amendment proceedings under sections 122(9) and 122(5A) of the Ordinance.

Section 109 was then invoked to re-characterise the sale and repurchase transactions. The officer treated the gain not as exempt capital gain under Rule 6A but as appreciation of investment under Rule 5(b) of the Fourth Schedule and raised a tax demand.

The insurance companies challenged that treatment. The Appellate Tribunal Inland Revenue accepted that the increased market value could not previously have been reflected because of the binding accounting framework. It found that the transactions served a genuine commercial and accounting purpose rather than a scheme whose main purpose was tax avoidance.

The Sindh High Court declined to interfere with the Tribunal's conclusions in the Income Tax Reference Applications. The Commissioner Inland Revenue then brought the connected appeals before the Supreme Court.

Section 109 requires a main tax-avoidance purpose

The Supreme Court treated the statutory language as decisive. Under section 109, re-characterisation depends on the existence of a tax avoidance scheme. The relevant definition required avoidance or reduction of tax to be a main purpose of the person entering into the transaction.

The word main imposes a real threshold. It is not enough to identify a reduction in tax after the transaction or to show that the taxpayer knew a tax advantage would follow. The Revenue must establish that obtaining that tax result was itself a principal or actuating purpose of entering into the arrangement.

The transactions did produce a tax benefit because Rule 6A exempted the capital gains. But the evidence accepted by the Tribunal and High Court showed that the companies' main purpose was to capture the current market value of their shares in the accounts, improve the value shown for their assets and strengthen liquidity.

That business purpose was genuine and was not a sham. The exemption was a legal consequence of the transaction, but the Court held that it remained incidental to the principal accounting and commercial objective.

A tax benefit is not automatically tax avoidance

The most reusable principle in the judgment is the distinction between obtaining a tax benefit and entering into a tax avoidance scheme.

A transaction may lawfully achieve a commercial purpose and also attract an exemption, deduction or reduced tax liability provided by legislation. The presence of that advantage does not by itself authorize the Department to disregard or rewrite the transaction.

For section 109 to apply on this ground, Revenue must move beyond the result and prove purpose. It must establish from the structure, timing, documents, accounting treatment, surrounding conduct and economic effect that tax avoidance or reduction was one of the main reasons for the arrangement.

If the tax consequence is only incidental or consequential to a genuine primary purpose, the statutory test is not met.

This does not create immunity for every transaction carrying a business label. The asserted commercial purpose must be real and supported by the record. A sham, circular arrangement with no substantial non-tax purpose may produce a different result. The present judgment turned on concurrent findings that the transactions were genuine and that the accounting objective was their main purpose.

Why Rule 5(b) did not convert the gain into appreciation of investment

The Revenue relied on Rule 5(b) of the Fourth Schedule and attempted to treat the realised gain as appreciation of investment.

The Court examined what the companies had actually recorded. Before sale, the portfolios appeared at their original acquisition cost. After repurchase, the shares appeared at the new acquisition cost. The companies did not take a separate credit in their accounts for an appreciation of investment.

The Supreme Court therefore held that the transactions could not be brought within Rule 5(b) merely because the new carrying value was higher than the old cost. In the absence of the corresponding accounting credit contemplated by the Rule, the Revenue's characterisation was not supported by the record.

The realised gain fell within Rule 6A as it stood for Tax Year 2007. The exemption enacted by Parliament could not

be denied merely by renaming the genuine capital gain as appreciation of investment when the statutory requirements for that treatment were absent.

Strict interpretation of taxing statutes supported the taxpayers

The judgment reaffirmed the established principle that tax liability must arise from clear statutory language. Nothing can be added to a taxing provision by intendment, equity or implication.

Where two reasonable interpretations of a charging or taxing provision are available, the interpretation favourable to the taxpayer is preferred. The Court referred to the well-known approach in *Cape Brandy Syndicate v Inland Revenue Commissioners* and its consistent recognition in Pakistani tax jurisprudence.

On the record before it, one possible view was that the companies acted to reflect the increased market value of their shares and improve their accounts. Another possible view favoured Revenue and treated the transactions as undertaken solely to avoid tax.

The Tribunal and High Court had accepted the former view on the facts. The Supreme Court found no ground to displace it. Even if another interpretation were possible, Rule 5(b) and the expression appreciation of investment had to be construed in favour of the taxpayers rather than enlarged against them.

Foreign anti-avoidance tests cannot be imported without statutory support

The Supreme Court also approved the caution shown by the Sindh High Court regarding anti-avoidance doctrines developed in other jurisdictions.

Pakistan's anti-tax-avoidance regime must be applied through the text of section 109 and the connected provisions of the Income Tax Ordinance. Tests or doctrines from foreign systems cannot simply be transplanted if they impose a different or broader standard than the language enacted by Pakistan's legislature.

Comparative law may assist interpretation, but it cannot replace the statutory requirement that tax avoidance must be a main purpose of the transaction.

What the Court did not decide

The connected cases also raised a wider question about the relationship between section 99 and the Fourth Schedule, on one side, and the general provisions of sections 67 and 109 on the other.

The insurance companies had argued that section 109 did not apply to insurance businesses unless specifically incorporated into the Fourth Schedule. The later Sindh High Court judgment had treated section 109 as a new statutory tool capable of operating within the insurance tax framework.

The Supreme Court did not finally resolve every aspect of that wider issue. The insurance companies had not filed a cross-appeal against the finding concerning the applicability of section 109, as the ultimate result was already in their favour.

The Court decided the appeals on the narrower and sufficient ground that, even assuming section 109 was available, its main-purpose requirement was not satisfied and Rule 5(b) did not apply to the transactions proved on the record.

The judgment therefore must not be misreported as holding that section 109 can never apply to an insurance company. Its actual holding is more precise: section 109 cannot sustain re-characterisation where Revenue fails to prove the required main tax-avoidance purpose.

The notice requirement and the Revenue's evidentiary burden

The Court observed that re-characterisation under section 109 requires notice to the person who entered into the transaction. That requirement was met because the notices were directed to the insurance companies whose transactions were under examination.

Notice alone, however, did not establish the case. After initiating the process, Revenue still had to prove the statutory elements justifying re-characterisation.

In practical terms, an order under section 109 should identify the impugned transaction, the taxpayer's asserted commercial purpose, the evidence said to disprove that purpose, the tax advantage obtained, and the facts showing that avoidance or reduction of tax was a main purpose rather than a secondary consequence.

A conclusion based only on the size of the exemption or the existence of associated parties will not necessarily satisfy that burden.

The final outcome

The Supreme Court dismissed all 20 civil appeals filed by Revenue. It upheld the result reached by the Appellate Tribunal Inland Revenue and the Sindh High Court, leaving the capital gains exemption under Rule 6A available for the relevant transactions and Tax Year 2007.

The Court held that Revenue had acted illegally in re-characterising the transactions and denying the exemption. The companies' genuine purpose of recording the higher market value of their shares was accepted, while the resulting tax benefit remained incidental.

The two applications filed by Habib Insurance Company Limited to set aside ex parte orders lost their relevance after the connected appeals were decided in its favour and were disposed of.

Practical guidance for taxpayers

A taxpayer relying on a genuine commercial purpose should preserve a contemporaneous record showing why the transaction was undertaken. Useful material may include:

- board resolutions and internal approvals identifying the business objective;
- regulatory or accounting rules that created the commercial need;
- financial statements showing the treatment before and after the transaction;
- valuation and liquidity evidence;
- transaction documents and proof of actual settlement;
- advice prepared before the transaction rather than after the dispute arose; and
- evidence separating the commercial benefit from the resulting tax treatment.

The judgment protects genuine arrangements, not unsupported explanations invented after assessment proceedings begin.

Practical guidance for Revenue authorities

Revenue should not treat every exempt or tax-efficient transaction as avoidance. The inquiry should focus on purpose, commercial reality and the statutory elements of section 109.

Where avoidance is alleged, the order should explain why the asserted business purpose is false, insignificant or subordinate to the tax objective. It should also identify the precise provision authorizing the proposed re-characterisation and show how the transaction falls within that provision.

For insurance businesses, the relevant accounting and regulatory framework must be read with the Fourth Schedule. A higher post-transaction acquisition cost cannot automatically be labelled appreciation of investment without examining the entries actually made in the accounts.

Continuing significance and historical limits

The dispute concerned Tax Year 2007 and Rule 6A as it then stood. Rule 6A was later omitted, so the judgment should not be used as though it creates a present exemption independent of the current law.

Its broader principle remains important: the statutory main-purpose test under section 109 cannot be replaced by a simple tax-benefit test. Genuine commercial purpose, accounting treatment and the difference between principal purpose and incidental consequence remain central to anti-avoidance analysis.

Taxpayers and Revenue authorities must apply the version of the Ordinance and Fourth Schedule governing the relevant tax year. The judgment explains the method of analysis; it does not freeze the legislation as it stood in 2007.

Conclusion

Commissioner Inland Revenue v EFU General Insurance Limited and connected insurance companies draws a clear line between lawful tax consequences and a tax avoidance scheme. A transaction is not re-characterised merely because it is tax-efficient. Revenue must prove that avoidance or reduction of tax was a main purpose of entering into it.

The Supreme Court found that these share sale and repurchase transactions had a genuine accounting and commercial objective: capturing increased market value that could not otherwise be reflected under the applicable regulatory framework. The capital-gains exemption was a consequence of that purpose, not the purpose itself.

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