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GOVERNMENT OF PAKISTAN
REVENUE DIVISION
FEDERAL BOARD OF REVENUE

Subject:- JUDGMENT OF HONORABLE LAHORE HIGH COURT LAHORE ON THE ISSUE OF CALLING OF RECORD BY THE COMMISSIONER FOR AUDIT U/S 177 (1) OF THE INCOME TAX ORDINANCE, 2001 IN W.P NO.4691/2010 AND 310 OTHER PETITIONERS.

Kindly refer to the above subject.

2. Three hundred and eleven (311) petitioners challenged the validity of notices issued by the Commissioner Inland Revenue for audit of their income tax affairs under section 177 of the Income Tax Ordinance, 2001 for tax year 2009 before the Lahore High Court Lahore.

3. The Honorable Court vide order dated 27.05.2015 (F/A) while dismissing all these petitions has held that:-

"41. For reasons recorded above, I find that the impugned notices were validly issued, and the Commissioner had the jurisdiction to issue notices in exercise of his powers under section 177 of the ITO, without selection of a person for audit by the FBR under section 214C of the ITO."

4. The Honorable Court in para-23 of the Order has also observed that:-

"..... the arguments of the learned Counsel for the petitioners that this power of Commissioner was taken away by virtue of Section 214C through Finance Act, 2010 is misconceived and not supported by the language of section 177 and 214C. If at all there was any ambiguity in the matter the legislature itself clarified and explained the same by inserting the afore-noted explanation where for removal of doubt it was declared that the powers of the Commissioner u/s 177 were independent of the powers of the Board u/s 214C and nothing contained in section 214C restricted the powers of the Commissioner to call for record or document including books of accounts of the taxpayer for audit and to conduct audit u/s 177 of the ITO."

5. The Honorable Court while adjudicating upon the ground taken by the petitioner that under section 120 of the Income Tax Ordinance, 2001 treating taxable income

lets discuss the implications of this (F/A-1)

Chief Justice

Circular no. 12

Fukhiz 17.06.15

SS (TPA)


declared in the return by an assessee as an assessment order vested right accrued in favor of the petitioner, in para 26 of the judgment has observed that:-

"26. Perusal of the Income Tax Ordinance, 2001 indicates that mere selection of a taxpayer for audit and calling of books of accounts to verify the version declared in his return under the USAS, which is the main theme on which the entire structure of the Income Tax Ordinance, 2001 has been built, does not cause any injury/prejudice to the taxpayer."

6. This judgment of the Court is of great significance not only for the reason that powers of the Commissioner for audit under 177(1) have been recognized but also for the reason that it has strengthened, the stance of department in more than 300 Intra Court Appeals pending before Lahore High Court against the judgment in case of M/s Chenone Stores & others, whereby the power of the Commissioners to call for record for audit u/s 177(1) were struck down by Single Bench of the same Court and also in Civil Petition pending before the Supreme Court on the same issue in the case of Northern Bottling.

7. Copy of the judgment of the Honorable Court is enclosed for follow up action in cases where petitions have been dismissed.

Encl: As above.


(Rana Muhammad Luqman)
Chief (Legal-I)

The Member (IR-Operations), FBR, Islamabad

✓ The Member (TPA), FBR, Islamabad

U.O. No.1(3)SS(Lit-HC)/2010/35128-L dated 17.06.2015

Stereo. H C J D A 38.

Judgment Sheet

IN THE LAHORE HIGH COURT AT LAHORE
JUDICIAL DEPARTMENT

WP No.4691 of 2010

M/s. Kohinoor Sugar Mills vs. *Federation of Pakistan etc*

JUDGMENT

Dates of hearing: 03.04.2015, 24.04.2015, 08.05.2015, 15.05.2015,
27.05.2015.

Petitioners by: M/s. Shahbaz Butt, Muhammad Ajmal Khan, Naveed Amjad Andrabi, Muhammad Azhar Siddique, Shahid Parvez Jami, Salman Akram Raja, Syed Ibrar Hussain Naqvi, Rana Munir Hussain, Muhammad Naeem Shah, Khurram Shahbaz Butt, Sajjad Ali Jaafery, Abdul Quddus Mughal, Agha Sarfraz Ahmad, Ahsan ul Haq, Akthar Ali Monga, Asghar Ahmad Khari, Ch. Muhammad Aslam, Ch. Shahid Hussain, Ch. Zahid Attique, Dr. Ilyas Zafar, H.M. Majid Siddiqui, Habib ur Rehman, Ikram ul Haq Sheikh, Jan Muhammad Chaudhary, Javed Athar, Javed Iqbal Qazi, Mian Mahmood Rashid, Mian Muhammad Javed, Mirza Anwar Baig, Moeen Qamar, Mr. Khurram Shehzad Awan, Mudassar Shuja ud Din, Muhamad Naeem Munawar, Muhammad Aleem Irshad, Muhammad Amir Malik, Muhammad Ijaz Ali Bhatti, Muhammad Iqbal Hashmi, Muhammad Mansha, Muhammad Nadeem, Muhammad Naeem Munawar, Muhammad Waseem Chaudhary, Muhammad Younas Khalid, Muhammad Zahid Rana, Qadir Bakhsh, Saeed ur Rehman Dogar, Sarfraz Ahmad, Shahid Shaukat, Shehzad Mehmood Butt, Sufyan Umar, Suhail Ibne Siraj, Syed Ali Imran Rizvi, Syed Irfan Haider Shah, Syed Salman Haider Jaafery and Waqar Azeem, Advocates.

Respondent by: Mr. Imran Aziz, Deputy Attorney General for Pakistan.
M/s. Muhammad Ilyas Khan, Liaqat Ali Chaudhry,
Raja Sikandar Khan, Sarfraz Ahmad Cheema,

Muhammad Asif Hashmi, Syed Sajjad Haider Rizvi, Tariq Saleem Sheikh, Muhammad Nawaz Waseer, Mian Yousaf Umar, Javaid Athar, Imran Rasool, Shahid Sarwar Chahal, Ibrar Ahmad, Rai Tariq Saleem, Muqtidar Akhtar Shabbir and Safdar Mehmood, Advocates.

Ijaz ul Ahsan, J: Through this common judgment, I intend to decide this and other constitutional petitions mentioned in Annexure "A" to this judgment. All these petitions raise common questions of law and facts.

2. The petitioners have challenged the validity of notices issued by the Commissioner Inland Revenue for audit of their income tax affairs under Section 177 of the Income Tax Ordinance, 2001 ("ITO") for tax year 2009. Their case, as put forth by their learned counsels, is that proceedings to conduct audit of their income tax affairs have been commenced by the Revenue Authority without allowing them an opportunity of being heard. Resultantly, they have been deprived of their right to file their defence against the intended proceedings which is violative of the principles of natural justice. It has further been contended that the Commissioner Inland Revenue was under a legal obligation to disclose to the taxpayer the basis of selection for audit, confront him with such basis, invite objections from him and finally to pass a speaking order to justify such action. The main argument is that the Commissioner has not followed the aforementioned requirements of law. Consequently, the notices, the selection of cases for audit and the related

proceedings are malafide and utterly illegal. It is further argued that the selection of cases of the petitioners for audit is unlawful, illegal and without jurisdiction insofar as provisions of Section 177 of ITO relating to selection of cases for audit have been substituted through Finance Act, 2010 and a new Section 214-C has been inserted in the ITO. It is submitted that perusal of the substituted section 177 and newly inserted Section 214-C shows that the Commissioner Inland Revenue is no longer vested with the authority to select a person to conduct audit of Income Tax affairs of such person. His power is limited to conducting audit after selection has been made by the Federal Board of Revenue in terms of Section 214-C.

3. The learned counsel for the petitioners have argued that after the aforementioned amendments brought about by way of Finance Act, 2010, power of the Commissioner to select a person for audit has been taken away and the same has been vested exclusively in the Federal Board of Revenue ("FBR"). Therefore, having no power to select under Section 177, the notices issued by the Commissioner calling for record for the purpose of audit are without lawful authority, illegal, and void ab-intio.

4. The learned counsel for the petitioners have further argued that Section 214-C has been inserted while Section 177 has been substituted through Finance Act, 2010. Both new sections are

prospective and cannot be applied retrospectively. It is maintained that the tax year 2009 had already come to close on 30.06.2009 and the income tax returns for the said tax year stood filed and had attained the status of assessment orders on the date of filing, by operation of law in terms of Section 120 of the ITO. Consequently, a vested right had accrued in favour of the assessee which could not be taken away. The amendment in the law cannot be applied retrospectively unless the legislature has specifically given it retrospective effect. It is maintained that the notices addressed to the petitioners constitute a fishing expedition to look for evidence from the records and books of the petitioners. Such expeditions are not warranted by law. It is pointed out that respondent No.2 in any event was under a legal obligation firstly to disclose the basis of selection to the concerned person, secondly to confront him with such basis and finally after inviting objections from the concerned person, pass a speaking order so as to justify such selection. The Commissioner has not followed the aforementioned procedure in consequence of which, notices and proceedings emanating from such notices have lost their legal sanctity.

5. The learned counsel for the respondents, on the other hand, have argued that reasons were recorded by the Commissioners and the conditions of Section 177 were fulfilled in issuing such notices to the petitioners. They submit that even if in some instances reasons have not been communicated, no prejudice has been caused to the Petitioners.

They have merely been summoned by the Commissioner. Once they appear before him and prior to commencement of audit proceedings (if necessary), they would be confronted with the reasons for issuance of the notice and given full opportunity to meet such reasons and defend their position. As such no prejudice has been caused to the Petitioners. It is pointed out that after examining the record and confronting the taxpayers with the discrepancies, if any, in case the Commissioner is dissatisfied with the response, he may proceed to conduct audit of the income tax affairs of the assessee in accordance with law.

6. The learned counsel for the Respondents emphasize that the said audit is qualitatively different insofar as it is record based and on every step reasons are required to be recorded and such reasons are required to be disclosed to the assessee, who on being confronted has an opportunity to respond to the same and defend his position.

7. The learned counsels submit that selection of an assessee for audit by the Federal Board Revenue under Section 214-C is a totally different and independent power which is not record based. It is in the form of computerized balloting which may either be random or parametric. Once the Board undertakes such selection in exercise of its powers under Section 214-C and no reasons for such selection need be disclosed because there are none (except that the computer has picked up a name like a lottery), it may direct a Commissioner to conduct an audit

in accordance with the procedure prescribed under Section 177 or appoint a firm of Cost and Management Accounts to conduct an audit on his behalf. It is, however, clarified that there cannot be overlapping audit in that a person cannot be subjected to two audits, one on the basis of power exercised by the Commissioner under Section 177 and the other on the basis of selection by the Board under Section 214C of the ITO.

8. It is further submitted that in 2013, the position was further clarified and explained by the legislature by declaring that powers of Commissioner under Section 177 were independent of the powers of the Board under Section 214-C and that the provisions of Section 214-C did not restrict the independent power of the Commissioner to call for the record or documents including books of accounts of a tax payer for audit and to conduct audit under Section 177. They submit that simultaneously, a corresponding amendment was inserted in Section 177 to re-affirm the independent powers of the Commissioner to call for record under Section 177 and conduct audit under the said provisions. They further maintain that the amendments inserted in Section 177 and 214-C in 2013 clarified and explained the meaning, scope and intent of the legislature with regard to Section 177 and 214-C of the ITO.

9. Notwithstanding the above, it is submitted that even in the year 2009, the Commissioner enjoyed an independent power to call for

the record of a person or classes of persons and upon being satisfied that there were valid reasons to probe the matter, conduct audit having regard to the criteria given in Section 177(4)(a) to (e). They maintain that notices sent to the petitioners meet the criteria of the original as well as the amended section 177 ITO and therefore, cannot be struck down on the basis of technical objections.

10. The learned counsels for the respondents have vehemently argued that the audit provisions contained in Section 177 and 214-C are admittedly machinery provisions. It is settled law that such provisions are required to be construed liberally in order to facilitate the respondent department to perform its regulatory functions. It is pointed out that the exercise of powers by the Commissioner have been subjected to checks and balances at every level insofar as he is not only required to record reasons but also communicate such reasons to the assessee, who may contest the same and defend himself. Further, such decisions are justiciable before the appropriate fora in the hierarchy provided in the Income Tax Ordinance. It is, therefore, argued that the objections raised by the petitioners against the notices in question are not only pre-mature but also an effort to obstruct and delay a lawful process, which is required to be undertaken by the regulator to ensure that the trust reposed in the taxpayer by the law maker under the Universal Self-Assessment System ("USAS") introduced by the Income Tax Ordinance, 2001 is not abused or violated.

11. The Attorney General for Pakistan was put to notice under Order XXVII-A CPC. The learned Deputy Attorney General has made submissions on his behalf. He has adopted the arguments advanced by the learned counsels for the Respondents. He has, however, pointed out that having been given an independent power in terms of the amendments inserted in the Income Tax Ordinance, 2001 through Finance Act, 2010, the Commissioner has not been granted unbridled and unstructured discretion to select taxpayers for audit. He maintains that the power of the Commissioner to call for the record of any taxpayer for the purpose of conducting audit was always available to the Commissioner and continues to be available in view of the fact that the exercise of discretion by the Commissioner has already been defined and structured through cases reported as Messrs Syed Bhais (Pvt)Ltd through Director vs. Central Board of Revenue, Islamabad through Chairman and another (2007 PTD 239) and Ch. Muhammad Hussain and others vs. Commissioner of Income Tax (2005 PTD 152). He points out that certain observations made in the 2005 judgment *ibid* were struck down by the Hon'ble Supreme Court of Pakistan in its judgment reported as Commissioner of Income Tax and others vs. Fatima Sharif Textile, Kasur and others (2009 PTD 37). However, at page 40 of the judgment, it was observed by the Hon'ble Supreme Court of Pakistan that the Commissioner may issue notice in terms of Section 177 disclosing reasons for selecting a person for audit on the criteria laid down in Chaudhry Muhammad Hussain's case *ibid*. He submits that the

criteria laid down by the Hon'ble Supreme Court of Pakistan still holds field and is binding on the Commissioner who is obliged to disclose reasons for calling the record, give an opportunity to the taxpayer of being heard and in case he is dissatisfied with the explanation offered, he can proceed further to conduct an audit. He further maintains that even thereafter, opportunity of hearing to the taxpayer is available under Section 177(6) after completion of audit and Section 122(9) before an assessment is amended. He further submits that the intention of legislature has clearly and unambiguously been incorporated in the explanation inserted through Finance Act, 2013. After the said explanation, there can be no two views about the fact that the power of the Commissioner under Section 177 is independent of the powers of the Board under Section 214C and nothing contained in the said Section restricts the powers of the Commissioner to call for record or documents for audit and to conduct audit under Section 177.

12. I have heard the learned counsels for the parties and examined the record.

13. The following questions emerge from the arguments made at the bar:

i) Whether the impugned notices under Section 177 of the ITO were required to contain reasons for summoning the record to conduct audit of

the taxpayers and non-disclosure of reasons should automatically lead to such notices being struck down?

ii) Whether the Commissioner could have issued notices under Section 177 of the ITO as substituted by Finance Act, 2010 for the tax year 2009?

iii) Whether notices under Section 177 of the ITO could be issued by the Commissioner without selection of the case of the taxpayer for audit by the Federal Board of Revenue in terms of Section 214-C of the ITO?

14. Before I proceed to address the aforementioned issues, I consider it necessary to trace the changes that Section 177 of the ITO has undergone over the past few years. The contents of Section 177 of the ITO remained unchanged except for minor changes between 2002 to 2008, which are neither material nor relevant to the cases in hand. However, in the years 2009, 2010 and 2013 changes/additions were introduced. These being relevant for the purpose of deciding the lis are being reproduced below for ease of reference:

Finance Act, 2009:

177. Audit. (1) The Board may lay down criteria for selection of any person or classes of persons for an audit of such person's income tax affairs, by the Commissioner.

(2) *The Commissioner shall select a person or classes of persons for audit in accordance with the criteria laid down by the Board under sub-section (1).*

(3) *The Board shall keep the criteria confidential.*

(4) *In addition to the selection referred to in sub-section (2), the Commissioner may also select a person or classes of persons for an audit of the person's income tax affairs having regard to-*

(a) *the person's history of compliance or non-compliance with this Ordinance;*

(b) *the amount of tax payable by the person;*

(c) *the class of business conducted by the person; and*

(d) *any other matter which in the opinion of Commissioner is material for determination of correct income.*

(5) *After selection of a person or classes of persons for audit under sub-section (2) or (4), the Commissioner shall conduct an audit of the income tax affairs (including examination of accounts and records, enquiry into expenditure, assets and liabilities) of such person or classes of persons.*

