Government of Pakistan

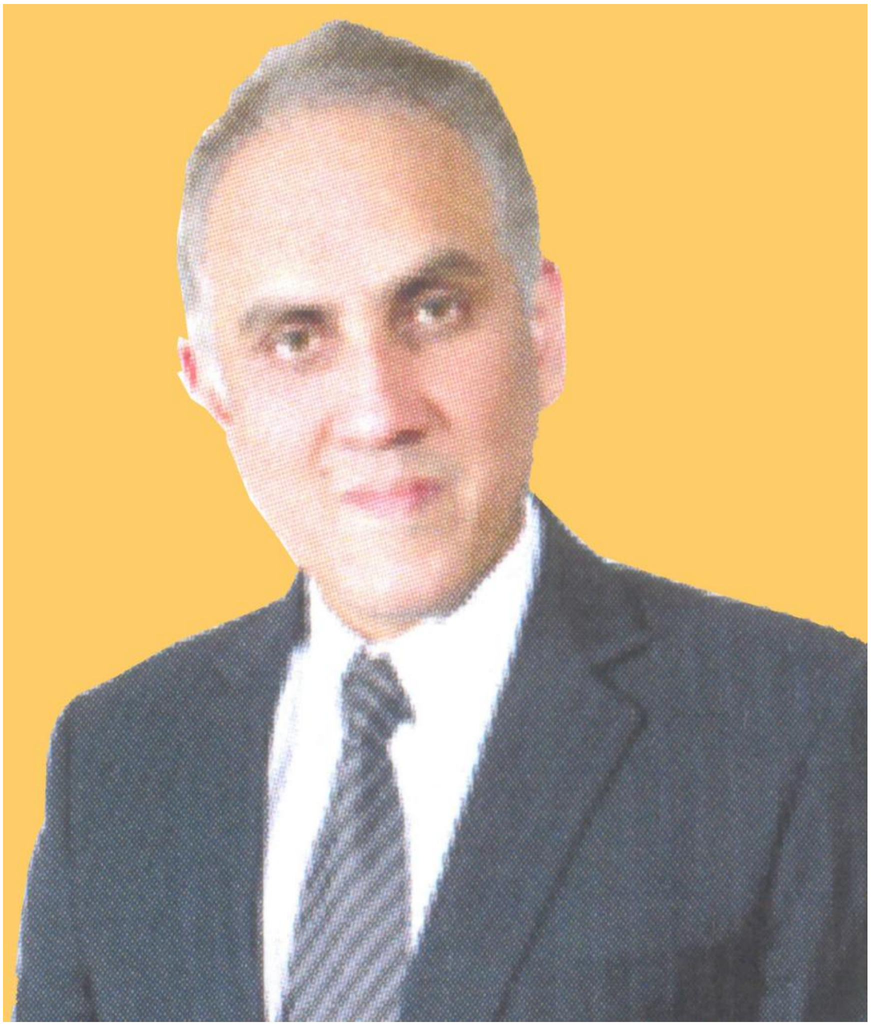
Annual Report

2011-2012

Directorate General of Internal Audit
(Inland Revenue)

Federal Board of Revenue
Islamabad.

December, 2012



Mr. Ali Arshad Hakeem
Chairman
Federal Board of Revenue

Ms. Sameera Yasin
Director General

C O N T E N T S

PREFACE

It is a matter of great privilege for me to present the Annual Report for the year 2011-12 to the honorable Chairman, Federal Board of Revenue, Islamabad. It highlights the performance of the Directorate General of Internal Audit (Inland Revenue) during the Fiscal Year. It also depicts difficulties while carrying out our official work.

The jurisdiction of the Directorate General of Internal Audit, Inland Revenue (IR) spans all over Pakistan in respect of Internal Audit matters of all the Large Tax Payers Unit (LTUs) and Regional Tax Offices (RTOs) of Inland Revenue Wing of the Federal Board of Revenue. The Director General is assisted by three Directors i.e. Northern Region, Islamabad, Southern Region, Karachi and Central Region, Lahore. The Directors are assisted by the Additional Directors, Deputy Directors, Assistant Directors and Extra Assistant Directors housed at almost all the major cities of the country.

Internal Control in an Organization is designed to help the Organization accomplish specific goals and objectives. Internal Auditing activity is primarily directed at improving internal control and setting the standards of Excellence. It also works as a tool by which Organization's resources are monitored and measured. The internal control system of the Federal Board of Revenue is regulated through the Directorate General of Internal Audit (Inland Revenue). It provides a progressive internal control system by conducting inspections and audit of the Inland Revenue Offices/ Officers and suggests corrective measures to detect fraud, leakages, irregularities and implementation gaps. Gaps are identified and follow up is made till the retrieval/settlement of loss of revenue detected.

The Directorate General of Internal Audit (Inland Revenue) carries out its function in the light of the Manual of Internal Audit (Revenue & Expenditure), 2011 wherein functions of various authorities, their jurisdiction, scope and procedures, etc have been redefined. The said Manual also includes guidelines to be followed by the Internal Audit (Inland Revenue) authorities.

The Directorate General of Internal Audit (Inland Revenue) is facing various shortcomings and odds with regard to shortage of officers/officials, lack of resources and facilities. Shortage of officers/staff coupled with frequent transfers without consulting the Director General caused delays in fulfillment of planed work thus hampering our efficiency. It is pertinent to mention here that 9 posts of Additional Directors (BS-19) out of sanctioned strength of 16 Additional Directors in the Directorate General remained vacant during the year 2011-12. Similarly, most of the posts of officers of BS-16/17 and 18 also remained vacant during the period under reference. Non-availability of the Officers adversely affected the Inspection and Audit work. Further, timely response from field formations regarding follow up of pending Inspection and Audit reports is not received. Despite all these impediments, the officers and staff of the Internal Audit (Inland Revenue) have managed to move ahead and are carrying out their assignments efficiently. The Directorates of Internal Audit (IR) by hard work and effective professional scrutiny methods have pointed out huge loss of revenue and proposed remedial action through Inspection and Audit reports. The situation necessitates that the suitable officers may be posted in the Directorate General of Internal Audit (IR) in order to make the Organization viable. Furthermore, the mandate of the Organization be extended by incorporating changes in the law to confer powers upon it to take action against the defaulting officers for non-compliance within the time limit as prescribed in the Manual of Internal Audit (Revenue & Expenditure), 2011. It becomes necessary to give due importance to the inspection and audit reports so that the generation as well as collection of revenue may be enhanced. It will also increase the functional capabilities of the officers/officials.

The mandate of the Directorate General of Internal Audit (IR) stands extended to Sales Tax and Federal Excise functions vide Federal Board of Revenue’s notification No. 1046-02/SSM/2010 dated 28-04-2010. Since, most of the officers and officials of the Internal Audit (IR) are not skilled to deal with the matters pertaining to Sales Tax and Federal Excise Duty and there is also acute shortage of Auditors, therefore, the Directorate General has to strive hard in achieving the desired results pertaining to Sales

Tax and FED cases. However, Inspections and Audits have been conducted in respect of Sales Tax and FED cases and substantial loss of revenue has been retrieved.

As a result of hectic efforts of the Directorate General, 424 audit reports in respect of Direct and Indirect Taxes were prepared and 221 audit reports were finalized during the year 2011-12. Resultantly, loss of revenue amounting to Rs.37699.283 (M) was retrieved for the year 2011-12 as compared to the last year's retrieval at Rs. 27348.325 (M) which reflects a sizeable increase. The retrieval of loss of revenue of Rs. 37699.283 (M) on account of audit is inclusive of retrieval of Sales Tax at Rs. 950.423 (M) and Federal Excise Duty at Rs. 14417.477 (M) which is indicative of the fact that the officers and staff of Internal Audit are combating the challenges of Inland Revenue Service (IRS) effectively and efficiently with professional skills. The Directorate General also concentrated its efforts on retrieval of loss pertaining to earlier years which has been mentioned in the relevant parts of the report. During the period under review, 385 inspection reports were prepared and loss of revenue of Rs. 10590.600 (M) inclusive of Rs. 2009.192 (M) on account of Sales Tax was retrieved despite the shortage of Additional Directors.

Special initiatives have also been taken by conducting Special Inspections in respect of Sales Tax in the cases of M/s. Lahore Electric Supply Company, M/s. National Transmission & Dispatch Company Limited, M/s. GEPCO & Steel Melters, Gujranwala, M/s. Multan Electric Power Company, M/s. M.H. Plastic Industries and M/s. WAPDA. Through these inspections, huge loss of revenue has been detected and the Special Inspection reports have been forwarded to the respective LTUs/RTOs for remedial action as per law. Details have been given in the relevant chapter.

The plan during the current year is to conduct Special Inspection in respect of selected sectors and to liquidate audit and inspection reports for the past years and synchronize the functioning of Directorate General of Internal Audit (IR) for Direct and Indirect Taxes.

The Annual Report contains articles written by the officers of the Directorate General from which the Officers of Inland Revenue would certainly benefit while discharging their functions.

Last but not the least, it is important to mention that the function of Internal Audit is very technical and specific in nature. There is a dire need to focus on proper training needs of the officers both, at the recruitment level i.e. in the specialized training programmes as well as during in-service Capacity Building Training Programmes. Such an ongoing activity shall enhance the audit skills of the officers aimed at improving the working of the Organization and reducing the burden of External Audit at all levels. The core spirit to be inculcated is to work with responsibility and a spirit of ownership with the Organization.

The efforts of the officers and officials, of the Directorate General, in finalization of this report are highly appreciated. The presentation and publication of the Report has been possible due to hard work put in by all the officers and officials of this Directorate at all levels. However, I express my heartfelt gratitude to the officers and officials of the Directorate General, Camp Office, especially Mr. Ijaz Ahmad, Second Secretary and Mr. Nawaz Ali Ansari, Inspector, Inland Revenue.

The services of Mr. Amir Mushtaq, LDC are also appreciated for his hard work and assistance in typing and composing work.

I personally believe that much more needs to be done to improve the working of the Directorate General. It is my humble request to the Chairman, FBR to plug the shortcomings of human resources and logistics which act as a deterrence to optimize the Organizational goals.

(SAMEERA YASIN)
Director General

Chapter – 1

INTERNAL AUDIT – HISTORY EVOLUTION & PRESENT ORGANIZATIONAL SET UP, MANDATE

Objective and Brief History:-

1. An organization exercises internal control in order to accomplish specific goals and objectives. The Directorate General of Internal Audit (Inland Revenue) being Internal Control of Federal Board of Revenue safeguards revenue leakages, checks the accuracy and reliability of departmental working, promotes efficiency, and encourages adherence to prescribed laws and procedures. Since its inception the Directorate General has proved to be custodian of state revenues.

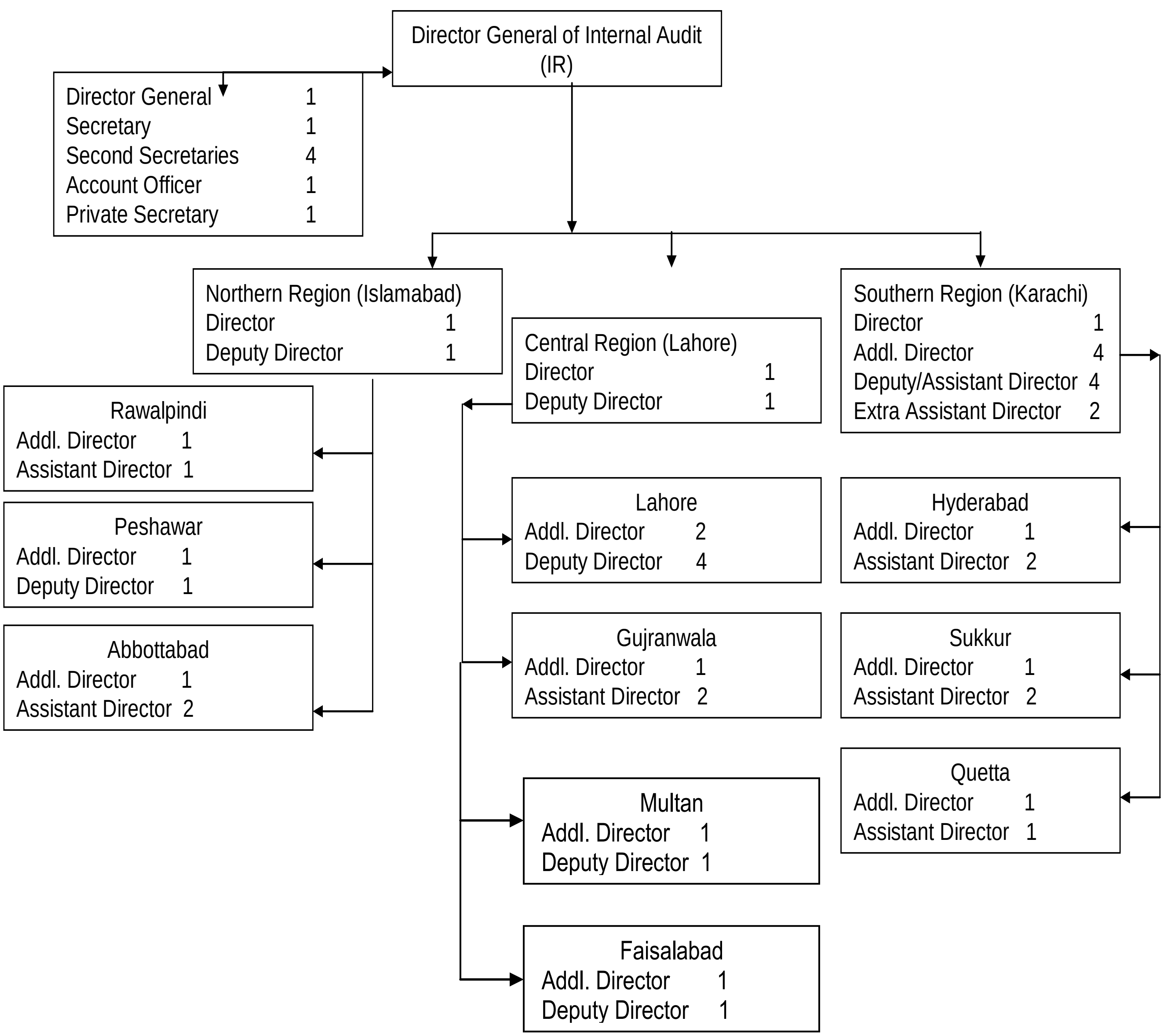
2. The Directorate General has excellent record of detection of tax evasion, under-reporting, under-assessments and issuance of bogus/illegal refunds caused due to inefficiency, corrupt practices, lack of adequate skills, omissions and commissions. This inter-alia includes incorrect application of law, non-maintenance of proper records, wrong appreciation of facts, mal-practices and connivance, improper training and lack of knowledge of respective trades and procedural lapses. The core functions performed by the Directorate General are remedial, curative and preventive in nature. The Inspection and Audit authorities make recommendations for an efficient system with the objective to create a taxpayers' friendly transparent culture envisioned in Tax Administration Reform Programme.

3. The "Directorate of Inspection & Audit" was created through CBR's (now FBR) notification, which remained valid up to 1991. It was upgraded as "Directorate General of Inspection, Audit & Enquiries (Direct Taxes)" in 1991, and was attached to the Ministry

of Finance. It was re-organized/re-designated as a statutory body through Finance Act, 1995 and was re-named as Directorate General of Inspection (Direct Taxes) in 1995.

4. The administrative control was reverted to the CBR/Revenue Division in 1996. Through Finance Act (2007), this organization was renamed as "Directorate General of Internal Audit (Direct Taxes)" and it reports to the Chairman, FBR. With the inception of the Inland Revenue Service and consequential re-structuring, the mandate of the Directorate General of Internal Audit (IR) has been redefined which has been discussed in details in subsequent paragraphs. Organizational set up of the Directorate General of Internal Audit (IR) is as under:

ORGANOGRAM



Mandate:-

The Directorate General derives its mandate from Section 228 of the Income Tax Ordinance, 2001. Its functions, jurisdiction and powers have been specified vide SRO No.660 (1)/2005 dated 30-06-2005. Section 228 and the said SRO are reproduced for the sake of convenience as under:

Section 228. **The Directorate-General of Internal Audit.** (1) The Directorate General of Internal Audit shall consist of a Director-General and as many Directors, Additional Directors, Deputy Directors and Assistant Directors and such other officers as the Board, may by notification in the official Gazette, appoint.

SRO No.660 (1)/2005. The Federal Board of Revenue has specified functions, jurisdiction and powers of the Directorate-General of Internal Audit (Direct Taxes) as under:-

"In exercise of the powers conferred by sub-section (2) of section 228 of the Income Tax Ordinance, 2001 (XLIX of 2001), the Central Board of Revenue is pleased to specify functions, jurisdiction and powers of Directorate-General of Inspection (Direct Taxes) as under, namely,

Inspection authorities: - (1) The Directorate General of Inspection shall consist of the following namely: -

(a) Director General of Inspection
(b) Directors of Inspection
(c) Additional Directors
(d) Deputy Directors
(e) Assistant Directors
(f) Extra Assistant Directors

(2) The Directors, Additional Directors, Deputy Directors, Assistant Directors and Extra Assistant Directors of Inspection shall be subordinate to the Director General of Inspection.

(3) Additional Directors, Deputy Directors, Assistant Directors and Extra Assistant Directors of Inspection shall be subordinate to the Director of Inspection within whose jurisdiction they perform their functions.

(4) Deputy Directors, Assistant Directors and Extra Assistant Directors shall be subordinate to the Additional Director of Inspection within whose jurisdiction they perform their functions.

(5) Assistant Directors of Inspection shall be subordinate to the Deputy Director of Inspection within whose jurisdiction they perform their functions.

(6) Extra Assistant Directors of Inspection shall be subordinate to the Assistant Director of Inspection within whose jurisdiction they perform their functions.

Functions and powers: - (1) The functions of Directorate-General of Inspection shall be, as under, namely:

(a) to carry out inspections of income tax cases and offices;

(b) to investigate or cause investigation to be carried out in respect of cases involving leakage of revenue or evasion of taxes;

(c) to carry out internal audit of cases or offices involving income tax revenues and expenditure;

(d) to furnish an annual report about the working of income tax offices to the Central Board of Revenue (now Federal Board of Revenue) by the thirty-first day of December, following the end of the financial year to which it relates; and

(e) to carry out any other work or function that may be assigned to it by the Federal Government.

(2) In discharge of its functions under (1) above, the Directorate General of Inspection shall have the powers specified in section 176 of the Income Tax Ordinance, 2001.

Jurisdiction:- (1) The Directors of Inspection shall perform their functions in respect of such persons or classes of persons or such areas as may be assigned to them by the Director General of Inspection.

(2) The Director General or a Director of Inspection may assign any function in respect of any area, or office or offices located within an area, case, class of cases, persons or classes of persons to any inspection officer working under his control.

***Explanation*: -** "Inspection Officer" means an Additional Director, a Deputy Director, an Assistant Director and an Extra Assistant Director.

The notification shall take effect from 1st July, 2005."

2. Consequent upon the amendments made in the Income Tax Ordinance, 2001 through Finance (Amendment) Ordinance, 2009 and renaming of tax functionaries as the officers of Inland Revenue accordingly, the Board, vide order C.No.1(6) IR-Judicial/2009 dated 11th November, 2009 conferred powers under the Ordinance of 2001 to the re-designated officers. Similarly, vide notifications of even number, powers conferred to the authorities under the Sales Tax Act, 1990 and the Federal Excise Act, 2005 have also been conferred to the officers of Inland Revenue. Subsequently, vide notification No. 1046-02/SSM/2010 dated 28/04/2010; the Directorate General of Internal Audit (Direct Taxes) has been renamed as the Directorate General of Internal Audit (Inland Revenue); The Regional Directorates of Internal Audit (Direct Taxes) and the offices of Additional Directors of Internal Audit (Direct Taxes) have also been renamed accordingly. Vide S.R.O. 282(I)/2010 dated 29/04/2010, necessary powers under the Sales Tax Act, 1990 have been assigned to the officers of Internal Audit (Inland Revenue). Similarly, vide S.R.O. 284(I)/2010 dated 29/04/2010, necessary powers under the Federal Excise Act, 2005 have also been assigned to the officers of Internal Audit (Inland Revenue). In view of the foregoing, the mandate of the Directorate General, Internal Audit (Inland Revenue) stands extended to the Sales Tax and Federal Excise functions as well.

JURISDICTION OF THE DIRECTORATE GENERAL OF INTERNAL AUDIT (INLAND REVENUE)

1. The Directorate General of Internal Audit (IR) holds jurisdiction in respect of Internal Audit matters of the Inland Revenue wing of the Federal Board of Revenue and is headed by a BS-21 officer. He/She is assisted by three Directors (BS-20) as under:-

(1) Director, Northern Region, Islamabad.
(2) Director, Central Region, Lahore.
(3) Director, Southern Region, Karachi.

JURISDICTION OF DIRECTORATES OF INTERNAL AUDIT (IR)

(1) NORTHERN REGION, ISLAMABAD

S.No.	Name of the Office Falling Within Jurisdiction
1	LTU, Islamabad
2	RTO, Islamabad
3	RTO, Rawalpindi
4	RTO, Abbotabad
5	RTO, Peshawar

(2) CENTRAL REGION, LAHORE

S.No.	Name of the Office Falling Within Jurisdiction
1	LTU, Lahore
2	RTO, Lahore
3	RTO-II, Lahore
4	RTO, Multan
5	RTO, Gujranwala
6	RTO, Sialkot
7	RTO, Faisalabad
8	RTO, Bahawalpur
9	RTO, Sargodha

(3) SOUTHERN REGION, KARACHI

S.No.	Name of the Office Falling Within Jurisdiction
1	LTU, Karachi
2	RTO, Karachi
3	RTO-II, Karachi
4	RTO-III, Karachi
5	RTO, Sukkur
6	RTO, Hyderabad
7	RTO, Quetta

SANCTIONED STRENGTH VIS A VIS WORKING STRENGTH

BS	SANCTIONED	WORKING	VACANT
BS-21	1	1	-
BS-20	3	3	-
BS-19	16	9	7
BS-17/18	23	14	9
BS-16	13	17	-4
Sub Total (officers)	**56**	**44**	**12**
BS-15	1	1	-
BS-14	98	80	18
BS-12	5	4	1
BS-11	-	-	-
BS-10	-	-	-
BS-9	51	45	6
BS-7	36	32	4
BS-5/4	15	14	1
BS-3/2	76	64	12
Sub Total (Officials)	**282**	**240**	**42**

OVERALL POSITION (ALL RANKS)

Sanctioned Strength	Working Strength	Vacant Posts
338	**284**	**54**

2. Although the acute shortage of officers and staff is adversely affecting the official work both in terms of quality and quantity, nevertheless loss of revenue on account of internal audit has been reported at Rs. 108672.365 (M) and retrieval of loss of revenue has been made at Rs. 37699.283 (M) on account of audit (Revenue) and Rs. 10590.600 (M) on account of inspection.

3. The Directorate General through its Directorates, not only strives for retrieval of explicit loss of revenue but also ingrains internal controls, which help in promoting efficiency, encouraging adherence to law and procedures thus improving overall working of the tax machinery. These internal controls are in the form of ensuring maintenance of obligatory registers, monitoring of withholding taxes, giving timely appeal effect,

issuance of un-served assessment orders, completion of pending assessments, utilization of information, disposal of rectification applications, accurate reporting of revenue figures in the MPR etc. These ensure effective control in the field formations.

AUDIT

Internal Audit (Revenue)

Preamble:-

The purpose of Internal Audit is to ensure compliance of tax laws and to act as deterrence to tax evasion/avoidance by tax payers. Its objectives include examining fairly, independently and impartially leakages and loss of revenue due to negligence, inefficiency, omission or commission and reporting its retrieval.

Under SRO 660(1)/2005 dated 30-06-2005, the Directorate General of Internal Audit (Inland Revenue) has been entrusted to "carry out Internal Audit of cases or offices involving tax revenue and expenditures ". Thus, one of the most important tasks assigned to the Directorate General of Internal Audit (Inland Revenue) is to conduct audit with the object to verify the correct application of law and rules by field officers. The Directorate General of Internal Audit (Inland Revenue) carries out Internal Audit of cases of taxpayers or offices of Inland Revenue with a view to enhance the revenue generation and collection capabilities of the Federal Board of Revenue by identifying improper application of tax laws, rules and regulations in respect of direct and indirect taxes.

In the wake of introduction of Universal Self-Assessment Scheme through Income Tax Ordinance, 2001, any return filed under the said scheme qualifies for acceptance under section 120 of the Ordinance. The procedure for audit of person's income tax affairs and its completion has been laid down in section 177 of the Income Tax Ordinance, 2001. However, element of omission and commission cannot be ruled out. Therefore, one of the most important functions entrusted to the Directorate General is to conduct internal audit with the objective to check and point out deficiencies and irregularities causing loss of revenue and to ensure the correct application of laws and procedures by the field formation so as to create a fair, transparent and independent working environment.

Scope:-

The scope of audit has been enunciated in the Manual of Internal Audit (Revenue & Expenditure), 2011. The audit to be carried out by the Directorate General of Internal Audit (Inland Revenue) covers Revenue as well as Expenditure Audit in respect of direct and indirect taxes. In Revenue Audit, audit of a Division or a functional unit of Inland Revenue is conducted in order to examine the loss of revenue caused due to negligence, inefficiency, tax fraud, carelessness, etc. The purpose of audit is not only to detect and retrieve lost revenue but also to educate and assist field formations in correct application of law, rules and regulations so as to create a fair, transparent and efficient working environment.

Methodology:-

The Director of Internal Audit prepares annual schedule of Internal Audit (Revenue) by 15th June of financial year in respect of the financial year following the said date. The audit schedule approved by the Director is circulated to the respective officers, under intimation to the Director General, Internal Audit, to conduct audit as per procedure laid down in the Manual of Internal Audit (Revenue & Expenditure), 2011. Any change in the schedule, necessitated by special circumstances is also notified by the Director to respective officers/offices.

The Audit team headed by Deputy/Assistant/Extra Assistant Director assisted by Inspectors, Upper/Lower Division Clerks etc. intimates to the officer in the RTO/LTU, regarding audit schedule and visit his/her office to discuss the audit plan. The respective officer may allow access to the requisite records including MPR / performance data and record of proceedings conducted. Having access to the requisite record, the audit team prepares and communicates audit observations to the officer for necessary retrieval action within the stipulated time.

Areas of audit (Revenue):-

Revenue Audit is conducted in view of the following areas of work.

Income Tax

- Detection of improper application of tax rates.
- Checking arithmetic accuracy of computation of income, expenditure, assets and liabilities.
- Detection of misreporting, under-reporting and over-reporting of Direct Taxes Collection.
- Checking the accuracy of depreciation, initial allowance and amortization allowance.
- Detection of miscalculations of various allowances, tax credits, tax rebates and refunds and compensation thereof.
- Checking correctness of carry forward and set off of losses.
- Identifying improper deduction of Zakat, charge of Workers' Welfare Fund, Workers' Participation Fund, personal medical expenses, double credit on the basis of received and receivables, and detection of recouped expenditures.
- Detection of wrong and time barred rectification of mistakes, time barred refund applications and wrong issuance of refunds.
- Pointing out mismanagement / maladministration in the LTUs/RTOs due to non-maintenance or improper maintenance of prescribed records.
- Checking the entries of salary statement u/s 165 with declared and assessed income.
- Detection of fraudulent and fake tax payment receipts.
- Checking the correctness of brought forward arrears demand, additions and deletions thereof.
- Checking Incorporation Certificates in case of transfer and receipt of arrears demand.

- Checking the charge of additional taxes and imposition of penalties.

- Pointing out lapses in monitoring of withholding taxes and enforcement of statements u/s 165.

- Any other area covered under the law.

Sales Tax and Federal Excise Duty

- To review the criteria in vogue/in use for selection of audit cases.
- To evaluate the audit cases in so much as to the extent that the said audit was warranted.

- Review/evaluate the depth and quality of the audit conducted and the record examined by the auditors.

- To ascertain as to whether the conclusion of the audit is supported by the law and the procedure and appropriate penalties for offences detected have been considered.

- To review whether the record of the case and evidences/facts support the conclusion of the audit.

- To review the time cycle of the audit conducted and probe into the reasons in case of exceptional delays.

- To review the internal control as applicable in the organization to ensure the authenticity and transparency of the audit.

- To discover misreporting, under-reporting and over-reporting of indirect taxes collection.

- To check arithmetic accuracy of computation of tax liabilities.

- To detect improper application of tax rates.

- To check examination/classification aspects.

- To examine valuation aspects.

- To identify inadmissible exemptions/concessions.

- To point out mismanagement/maladministration in the Directorates General/LTUs/RTOs due to non-maintenance or improper maintenance of prescribed records.

- To detect wrong and time-barred actions, time-barred refund applications and wrong processing and issuance of refunds.

- To check the arrears/guarantees/bonds etc and recovery status thereof.

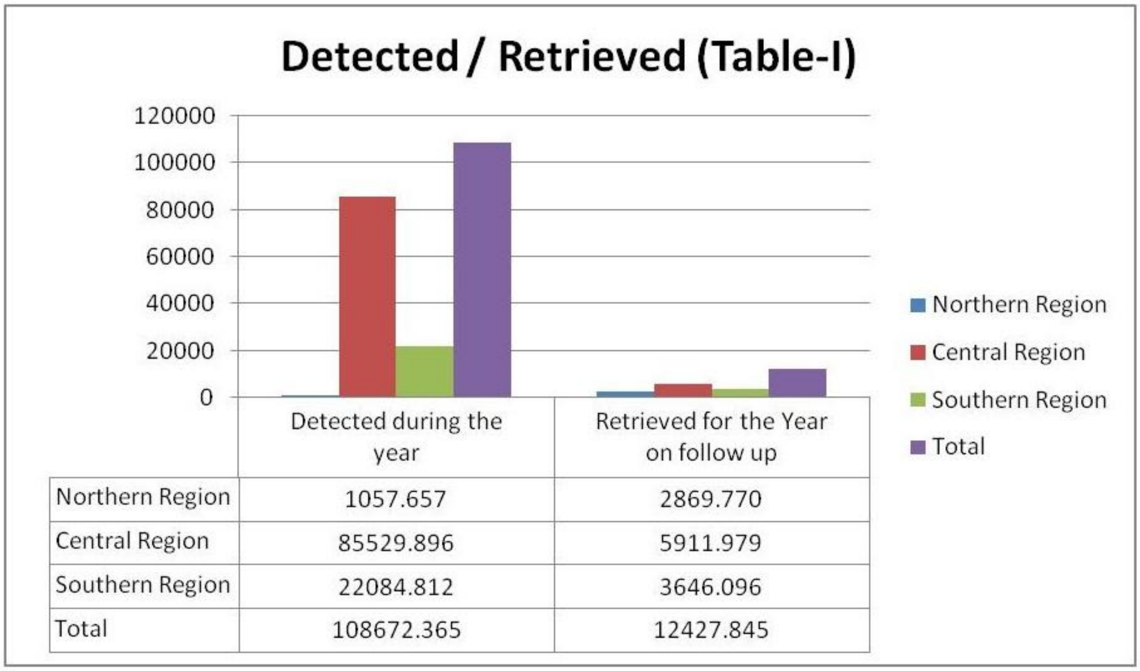
- Any other area covered under the law.

Performance during the Financial Year 2011-12

1. Loss of revenue detected/retrieved in current audit

Table-1

Region	No. of Units Audited	No. of Reports Finalized in Follow up	Loss of Revenue (M)	
			Detected during the year	Retrieved for the Year on follow-up
Northern Region	124	31	1057.657	2869.770
Central Region	198	94	85529.896	5911.979
Southern Region	102	16	22084.812	3646.096
Total	424	141	108672.365	12427.845



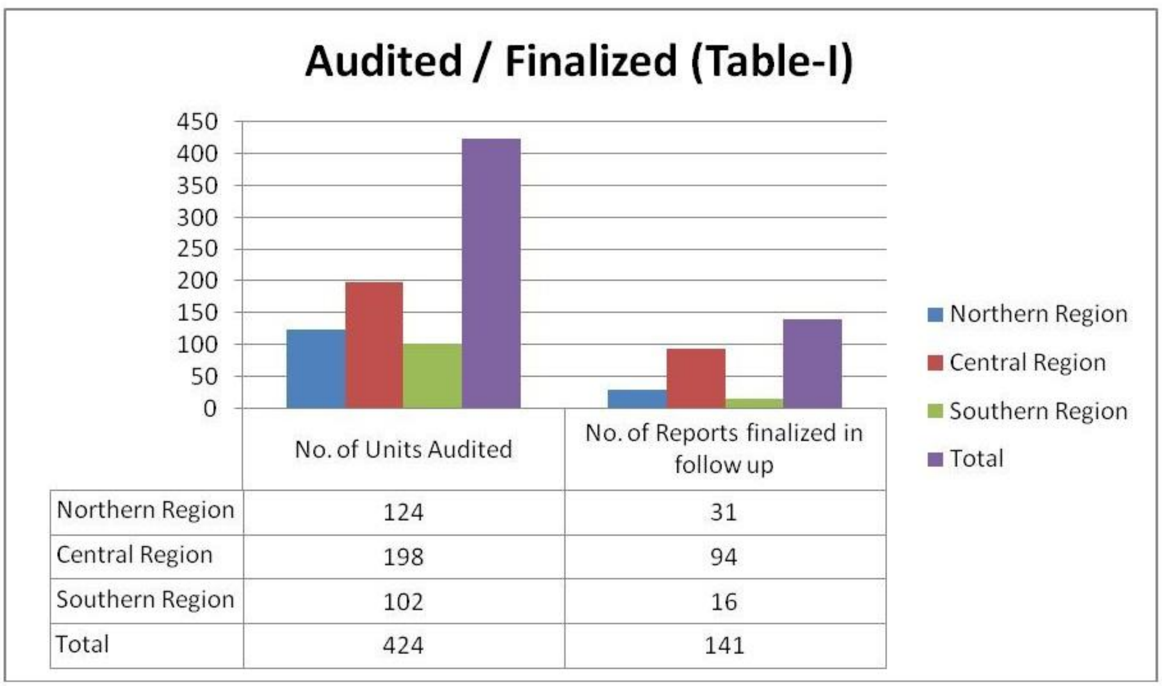


Table-1 reflects region-wise comparison of audit conducted, audit reports finalized, loss of revenue detected and retrieved. During the financial year 2011-12, audit of 424 functioning units was conducted and 141 audit reports were finalized in follow up. As per these reports loss of revenue of Rs.108672.365 (M) was detected out of which sum of Rs.12427.845 (M) has been retrieved. Loss of revenue detected for the year 2011-12 shows significant increase against the detection of loss of revenue at Rs. 49822.019 (M) during the immediately preceding year i.e 2010-11.

The above comparison also shows that the Central Region, Lahore contributed 78.70% to total loss of revenue detected during the year 2011-12, whereas retrieval made by the Central Region, Lahore constitutes 48% of total loss of revenue retrieved during the year under consideration which is examplary. The performance of the Central Region, Lahore has remained outstanding during the year 2011-12.

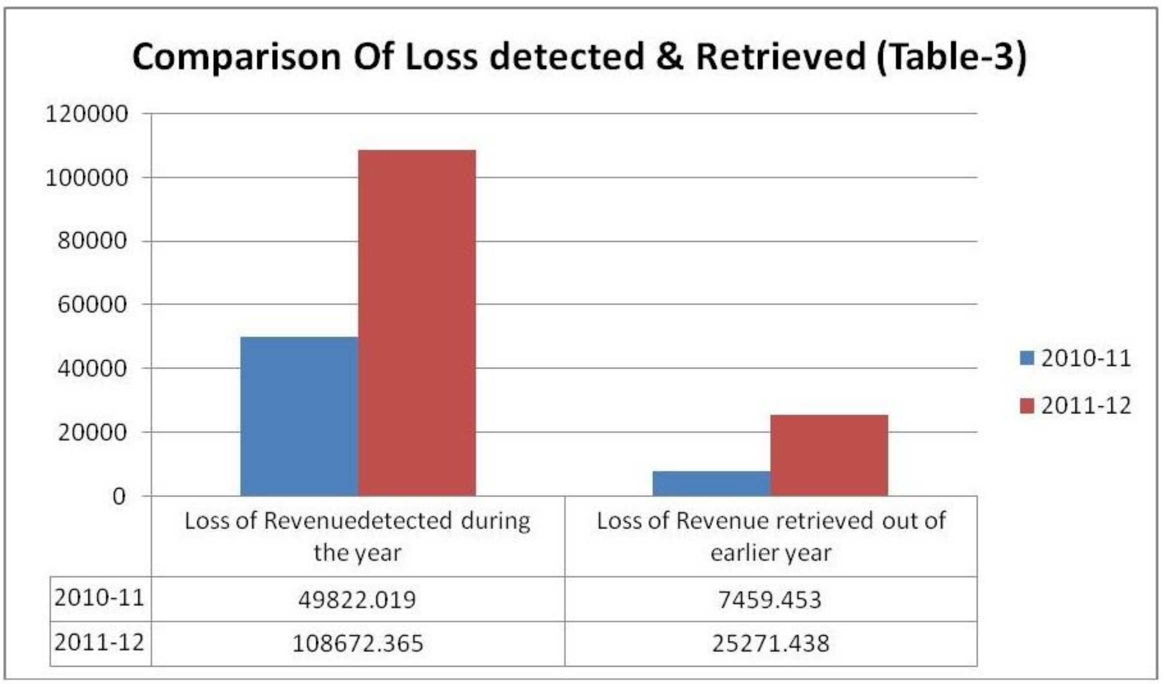
2. Retrieval of loss of revenue out of earlier years

Table-2		
Region	**No. of Units where follow-up action has been completed**	**Loss of Revenue (M)** **Retrieved up to 30.06.2012**
Northern Region	19	885.695
Central Region	53	12726.105
Southern Region	08	11659.638
Total:	**80**	**25271.438**

The data shown in table-2 above reflects the retrieval of loss of revenue pertaining to the earlier years due to the concerted efforts made by the Directorate General. Follow up action in respect of 80 units was completed and audit reports were finalized by the efforts of audit teams and loss of revenue of Rs. 25271.438(M) was retrieved during the year 2011-12 which shows an increase of 338.78% over the loss of revenue retrieved at Rs. 7459.453 (M) during the year 2010-11.

3. Comparison of loss detected and retrieved

Table-3			
		2010-11 (M)	2011-12 (M)
1	Loss of revenue detected during the year	49822.019	108672.365
2	Loss of revenue retrieved out of earlier years	7459.453	25271.438



As per table-3 above, performance in respect of loss detected through audits for the financial year 2011-12 and retrieval out of loss of revenue detected for the earlier years'. During the current year loss of revenue of Rs.108672.365 (M) was detected as compared to the loss of revenue detected at Rs. 49822.019 (M) for the preceding year, which is 2.18 times of the loss detected for the year 2010-11. The performance is, therefore, unprecedented.

4. Total revenue retrieved in 2011-12 (Including pending audit reports)

Table-4			
i) Current			
Region	**No. of Units Audited**	**Follow up/ compliance by 30.06.2012**	**Loss of Revenue retrieved(M)**
Northern Region	124	31	2869.770
Central Region	198	94	5911.979
Southern Region	102	16	3646.096
Sub Total:	**424**	**141**	**12427.845**
ii) Previous Years' Reports			
Northern Region	70	19	885.695
Central Region	175	53	12726.105
Southern Region	141	08	11659.638
Sub Total:	**386**	**80**	**25271.438**
Grand Total	**810**	**221**	**37699.283**

Table-4 reflects consolidated performance on account of retrieval of loss of revenue out of current year's audit as well as retrieval from previous year's audit reports. Total numbers of 221 reports were finalized during the year 2011-12 resulting in retrieval of revenue of Rs.37699.283 (M) which shows a considerable increase as against the retrieval of Rs.27348.325 (M) for the year 2010-11.

5. Comparative Analysis of Last Three years' Audits

Table-5

S.No.	Subject	2009-10	2010-11	2011-12
1.	Number of Circles/ Units audited.	301	375	424
2.	Number of cases audited.	19234	19369	6459
3.	Number of Circles/ Units where follow up action was completed.	229	270	221
4.	Number of Circles/ Units audited in previous years where follow up action was completed during current year.	131	141	80
5.	Percentage compliance in current year's Audit Reports.	33 %	34.4%	30.07%

The above table shows the comparative performance in respect of units audited, number of cases audited and number of units where follow up action was completed in the last three years. The analysis reveals that there is increase in number of units audit; however, compliance in follow up has been decreased due to non cooperation of the field formation as well as shortage of officers/ officials in this Organization.

6. Loss of Revenue detected on account of non/short levy of additional taxes

Table-6

(Figures in Million)

Section of Income Tax Ordinance, 1979/2001/	**Loss Reported (Rupees)**		
	2010-11	**2011-12**	**Percentage Increase/decrease**
Section 86/205(3)	1365.777	12540.085	918.17%
Section 87/205(1)	543.747	170.599	-31.37%
Section 88/205(1)	16.549	22.223	134.28%
Section 89/205(1)	550.920	161.959	-29.39%
Total	2476.993	12894.866	520.59%

Table-6 reflects the loss of revenue detected on account of short/non levy of additional taxes under various heads for the year 2011-12. The above data shows an increase of 520.59% during the current year over the detection of loss of revenue at Rs. 2476.993(M) for the year 2010-11.

7. Loss of Revenue on Account of Non/Short levy of additional tax u/s 205/86

Table-7

(Figures in Million)

S. No.	Offices	Directorate		
		Northern	**Central**	**Southern**
1.	RTO, Lahore.	-	11804.233	-
2.	RTO-II, Lahore.	-	666.206	-
3.	RTO, Gujranwala.	-	0.062	-
4.	LTU, Karachi	-	-	68.777
5.	RTO-II, Karachi	-	-	0.807
	Total:	**-**	12470.501	69.584
	Grand Total	**12540.085**		
	Region Wise Percentage	**-**	**99%**	**1%**

Region-wise performance on account of non/short levy of additional tax under section 205(3) of the Income Tax Ordinance, 2001 for failure to deduct/collect withholding taxes at the rates specified in the first schedule to the Income Tax Ordinance, 2001 is shown in table-7 above. The Central Region, Lahore has shown significant performance by detecting loss of revenue of Rs.12470.501 (M) which is 99% of the total loss detection under this head. During the year 2011-12 total loss of revenue was detected at Rs. 12540.085 (M) on account of non-levy of additional tax which shows an increase of 918.17 % against loss detected at Rs. 1365.777 (M) for the year 2010-11.

8. Loss of Revenue on Account of Non/Short levy of additional tax u/s 205/87

Table-8

(Figures in Million)

S. No.	Offices	Directorate		
		Northern	**Central**	**Southern**
1.	LTU, Islamabad.	0.451	-	-
2.	RTO, Peshawar	19.999	-	-
3.	LTU, Lahore	-	112.609	-
4.	RTO, Lahore	-	0.368	-
5.	RTO-II, Lahore	-	0.611	-
6.	RTO, Gujranwala	-	0.885	-
7.	RTO, Sialkot	-	0.245	-
8.	RTO, Faisalabad	-	1.870	-
9.	RTO, Sargodha	-	0.981	-
10.	RTO, M ultan	-	0.671	-
11.	RTO, Bahawalpur	-	0.030	-
12.	LTU, Karachi	-	-	22.567
13.	RTO, Karachi	-	-	2.985
14.	RTO-II, Karachi	-	-	6.327
	Total:	20.450	118.270	31.879
	Grand Total	**170.599**		
	Region Wise Percentage	**12%**	**69%**	**19%**

Table-8 above reflects detection of loss of revenue on account of non/short levy of additional tax under section 205 (1) of the Income Tax Ordinance, 2001 for failure to pay or timely deposit of any installment of advance tax due under section 147 of the Income Tax Ordinance, 2001. During the year 2011-12 total loss of revenue under this said head was detected at Rs.170.599 (M). The region-wise performance reveals that the Central Region, Lahore has detected loss of revenue of Rs. 118.270 (M) which constitutes 69 % of the total loss of revenue detected.

9. Loss of revenue on account of non/short levy of additional tax u/s 205/88

Table-9

(Figures in Million)

S. No.	**Offices**	**Directorate**		
		Northern	**Central**	**Southern**
1.	LTU, Islamabad	0.019	-	-
2.	RTO, Abbottabad	1.886	-	-
3.	LTU, Lahore	-	20.293	-
4.	RTO, Sialkot	-	0.025	-
	Total:	1.905	20.318	
	Grand Total	**22.223**		
	Region Wise Percentage	**9%**	**91%**	**-**

Region-wise data of loss of revenue detected on account of short/non levy of additional tax for failure to pay admitted liability under section 137 of the Income Tax Ordinance, 2001 for the year 2011-12 has been presented in table-9 above. The above data reveals that the Central Region, Lahore has retrieved loss of revenue detected on account of non-charging of additional tax under this head at Rs.20.318 (M) which is 91% of the total loss detected. This Table also indicates that bulk of audit work has been done in LTU, Lahore.

10. Loss of revenue on account of Non/Short Levy of Additional Tax u/s 205/89

Table-10

(Figures in Million)

S. No.	**Offices**	**Directorate**		
		Northern	**Central**	**Southern**
1.	LTU, Islamabad	0.590	-	-
2.	RTO, Peshawar	72.669	-	-
3.	RTO, Islamabad.	-	-	-
4.	LTU, Islamabad.	-	-	-
5.	LTU, Lahore		7.906	-
6.	RTO, Gujranwala.		5.944	-
7.	RTO- Sialkot.		2.150	-
8.	RTO, Multan		27.960	-
9.	RTO, Bahawalpur		7.959	-
10.	LTU, Karachi		-	26.291
11.	RTO-III, Karachi		-	2.324
12.	RTO,Sukkur		-	8.049
13.	RTO,Quetta		-	0.117
	Total:	73.259	51.919	36.781
	Grand Total	**161.959**		
	Region Wise Percentage	**45%**	**32%**	**23%**

Table-10 provides the figures of loss of revenue detected on account of non/ short levy of additional tax under section 205/89 of the Income Tax Ordinance, 2001 for failure to pay a part or whole of tax determined by the department. Loss of revenue has been detected at Rs.161.959 (M) under this head for the year 2011-12. Major contribution in detection of loss has been made by the Northern Region which constitutes 45% of the total detection where major audit work has been done in RTO, Peshawar.

11. Loss of revenue on account of Non/Short Charge of WWF

Table-11

(Figures in Million)

Offices Audited	**Directorate**		
	Northern	**Central**	**Southern**
LTU, Islamabad	105.746	-	-
RTO, Peshawar.	91.874	-	-
RTO, Abbottabad	0.060	-	-
LTU, Lahore	-	38.131	-
RTO, Lahore	-	70.313	-
RTO-II, Lahore	-	11.061	-
RTO, Gujranwala	-	0.923	-
RTO, Sialkot	-	5.800	-
RTO, Faisalabad.	-	37.755	-
RTO, Sargodha	-	5.786	-
RTO, Multan	-	2.291	-
LTU, Karachi	-	-	0.633
RTO, Karachi	-	-	0.560
RTO-II, Karachi	-	-	7.422
RTO-III, Karachi	-	-	1.270
RTO, Sukkur	-	-	5.820
RTO, Quetta			1.995
RTO, Hyderabad			0.010
Total	197.680	172.060	17.710
Grand Total	**387.450**		

Table-11 reflects the position of detection of loss on account of non-charging of WWF under section 4 of Workers Welfare Ordinance, 1971 for the year under reporting where loss of revenue has been detected at Rs.387.450 (M). The Northern Region has made major contribution in detection of loss under this head followed by the Central Region.

12. Loss of revenue due to Miscellaneous Irregularities

i) Northern Region, Islamabad.

Table-12

(Figures in Million)

S.No	Irregularity	Offices Audited			
		Abbott-abad	Peshawar	Rawalpindi	Total
1.	Wrong Calculation of Tax	-	-	277.343	277.343
2.	Arrears demand not brought forward(I. Tax)	2.289	-	-	2.289
3.	Current demand not brought forward.	7.270	-	-	7.270
4.	Arrears deleted without Incorporation certificates.	-	-	-	-
5.	Under Section 52	-	6.073	-	6.073
6.	Under Section 182	-	-	0.061	0.061
7.	Misc. (Income Tax)/ Other reasons (I.Tax)	49.567	79.533	53.403	182.503
8.	Other reasons (S.Tax)	76.147	36.850	143.998	256.995
9.	Other reasons (FED)	0.325	0.861	30.628	31.814
10.	Withholding tax	-	-	0.015	0.015
	Total Rs.	135.598	123.317	505.448	764.363
Grand Total Rs.		**764.363**			

ii) Central Region, Lahore.

Table-13

(Figures in Million)

S. #.	Irregularity	Office Audited								
	INCOME TAX	**LTU Lahore**	**RTO Lahore**	**RTO –II, Lahore**	**RTO Multan**	**RTO Bahawalpur**	**RTO Gujranawala**	**RTO Sialkot**	**RTO Faisal-abad**	**RTO Sargo-dha**
1.	Wrong Calculation of Tax	31.346	1.856	6.305	-	-	0.729	1.720	0.667	0.313
2.	Excess credit of tax.	-	0.257	-	-	-	-	-	-	-
3.	Arrears deleted without Incorpo-ration Certificates	1228.686	1681.530	1023.834	36.040	1.138	102.142	42.369	8.881	6.157
4.	Arrear demand not brought forward (I,Tax)	-	6472.180	1911.313	5.841	3.168	15.335	-	143.332	108.976
5.	Loss deleted u/s 161	2020.077	49870.030	2978.620	-	-	79.508	36.927	0.440	-
6.	Wrong/excess refund adjustment.	140.875	-	0.167	-	-	-	-	-	-
7.	Demand notices not served.	-	-	41.994	-	-	19.350	4.557	-	-
8.	Irregular written off arrear.	-	-	-	-	-	0.097	10.183	-	-
9.	Arrears recorded without incorporation certificate.	-	-	-	-	7.400	10.843	-	-	-
10	Difference of figures in DCR/Arrear & MPR.	-	-	1.562	40.415	3.576	205.238	169.267	-	-
11	Irregular credit of tax deducted at source.	-	-	-	-	-	0.664	4.600	-	-
12	Penalties.	-	0.307	0.606	-	-	-	-	-	-
13	Misc. Income Tax	327.678	2.100	19.401	-	-	12.575	-	303.363	10.769

	T total Income Tax Rs.	**3748.662**	**58028.260**	**5983.802**	**82.296**	**15.280**	**446.481**	**269.623**	**456.683**	**126.215**
SALES TAX & FED.										
1.	Non-filers	-	14.970	3.620	-	-	1.310	23.245	5.744	2. 380
2.	Short filers	-	30.075	1.147	-	-	-	-	0.270	0. 059
3.	Late filers	-	1. 240	1.000	-	-	-	-	-	-
4.	Arrear demand not b/f	-	5.39	35.687	-	-	-	-	-	-
5.	Demand not incorporated	-	281.579	-	-	-	-	-	-	-
6.	Arrear deleted without incorporation certificate	-	-	20.291	-	-	-	-	-	-
7.	Unlawfull adjustment	-	-	-	-	-	209.815	-	2559.781	114.37
8.	Others	-	36.62	-	-	-	-	-	185.985	4.948
Total Sales Tax &FED		-	369.869	61.745	-	-	211.125	23.245	2751.78	121.76
Grand Total. Rs.		**3748.662**	**58398.129**	**6045.547**	**82.296**	**15.282**	**657.606**	**292.868**	**3208.463**	**247.977**

iii) Southern Region, Karachi.

Table-14

(Figures in Million)

S. No.	**Irregularities**	**Offices Audited**						
		LTU Karachi	**RTO Karachi**	**RTO-II Karachi**	**RTO-III Karachi**	**RTO Hydera-abad**	**RTO Sukkur**	**RTO Quetta**
1.	Wrong Calculation of Tax	10.385	-	4.736	-	-	4.580	0.429
2.	Arrears deleted without in-corporation certificate.	84.339	10.143	9.243	-	173.308	-	-
3.	Misc. Income Tax (Other Reasons).	30.946	69.667	5.175	15.942	10.878	5.006	1.802
4.		-	-	-	20.713	-	-	22.890
5.	Arrear demand not brought forwarded.	-	5.129	2.577	-	-	-	3.450
6.	Misc. I. Tax.	20441.517	659.726	31.151	5.084	-	-	-
	Others/ S.Tax & FED.	300.004						
	Total	20867.227	744.665	52.882	41.739	184.186	9.586	28.571
	Grand Total	**21928.856**						

Tables-12, 13 and 14 reflect the loss of revenue detected by the Northern Region, Central Region and Southern Region pertaining to miscellaneous irregularities in addition to detection of loss of revenue on account of non/short levy of additional taxes and WWF. Major contribution of loss of revenue detected through audit relates to miscellaneous irregularities which include wrong calculation of taxes, arrears demand not brought forward and arrears demand deleted without obtaining incorporation certificate, etc. During the year 2011-12 total loss of revenue was detected at Rs.95390.049 (M) on this account against detection of loss for the year 2010-11 at Rs. 48728.327 (M). The above narrated region-wise data reveals that Central Region detected loss of revenue of Rs.72696.830 (M) which is a major contribution in detection of loss of revenue on account of miscellaneous irregularities. The Southern Region has also made a considerable contribution of Rs.21928.856 (M) towards the detection of loss by the Directorate General of Internal Audit, Inland Revenue.

Grand total of head-wise detection of loss

Tax Revenue Loss Detected During 2011-2012		
S.No.	**Additional Taxes**	**Loss of Revenue detected**
1.	Under Section 205(3)/86	12540.085
2.	Under Section 205(1)/87	170.599
3.	Under Section 205(3)/88	22.223
4.	Under Section 205(3)/89	161.959
5.	WWF	387.450
	Other Irregularities	
6.	i) Northern Region	764.363
7.	ii) Central Region	72696.830
8.	iii) Southern Region	21928.856
	Total	**108672.365**

The above table reflects summary of total loss of revenue detected at Rs. 108372.325 (M) for the year 2011-12 detected by the audit authorities under the head Revenue Audit in comparison with the immediately preceding year i.e 2010-11 where loss of revenue under all the heads of revenue audit was detected at Rs.49822.019 (M). The increase in detection of loss of revenue from audit function indicates the remarkable performance of the Directorate General during the year under reporting.

INSPECTION

Preamble:-

One of the most important functions assigned to the Directorate General, Internal Audit (Inland Revenue) is to carry out Inspection of the cases of the taxpayers and offices of Inland Revenue in order to ensure correct and judicious application of tax laws and procedures with a view to maintain internal control and improve the performance of tax administration.

With the creation of Inland Revenue Service, the mandate of the Internal Audit (IR) now stands extended to Sales Tax and Federal Excise functions, therefore, responsibilities of Internal Audit Authorities have increased manifold and the role of the Organization has become more significant. Further, the provisions of the Income Tax Ordinance, 2001 relating to deemed assessment as well as reorganization under Tax Administration Reform Programme on functional basis has also enhanced the responsibilities of the Organization.

The object of inspection is to keep control on the quality of output and also to ensure implementation of the FBR's policies for bringing about improvement of tax administration and service delivery. The scope of inspection encompasses detection of cases of concealment, underreporting, misreporting and tax evasion etc. It is based upon examination of records, details provided and third party information, which is, often found not easy to collect and correlate due to insufficient documentation / information in the present scenario.

Inspection may focus on the qualitative aspect of performance of the field officers with reference to their respective duties and functional jurisdictions and also to evaluate their statutory duties. The aim of inspection is to create a fair, transparent and independent working environment in order to enhance the revenue generation and collection capabilities of the FBR and to guide, educate and assist the field formations to improve overall quality of work as well as to plug the leakage of revenue.

Aims & Objectives:-

Inspection being the most important function of the Directorate General of Internal Audit (IR), aims at correct and judicious application of law, rules and procedures. The purpose of inspection is also to ensure high standards of assessments and report cases of inefficiency, omission and commission. Its objectives include evaluation of qualitative and quantitative performance of field offices, detection of tax evasion, retrieval of loss of revenue and other related matters.

Types of Inspections:-

Two types of inspections are conducted namely:-

(a) Regular inspection

(b) Special Inspection

Regular Inspection:-

Regular inspection is conducted by the Additional Director in respect of a Division, unit of a Division or any other office of RTO / LTU or a functional unit/ office of Inland Revenue as per schedule issued by the Director.

Special Inspection:-

Special inspection is conducted by the Director / Additional Director /Deputy Director as may be assigned by the Director-General of Internal Audit (Inland Revenue) or the FBR, in respect of assessment records of a particular taxpayer or class of taxpayers or inspection of records of a Division, unit of a Division or any other office of the RTO/ LTU or a functional unit, apart from the Annual Schedule of Regular Inspection.

Scope/Important Areas of Inspection:-

Inspection is conducted in view of the following areas of work.

(i) Audit Division

Income Tax

- Conducting of audit u/s 177 of the Income Tax Ordinance, 2001.
- Qualitative and quantitative disposal by amendment of assessments u/s 122 of the Ordinance.
- Computation of taxable income, giving effect to appeal orders and rectifications of orders in respect of cases related to audit.
- Assessments u/s 120, 120A, 143, 144 and 145 of the Ordinance.
- Revision of assessments u/s 122A & 122B of the Ordinance.
- Provisional assessments u/s 123 of the Ordinance.
- Best judgment assessments u/s 121 read with sub section (10) of section 177 of the Ordinance in respect of cases under audit.
- Imposition of penalty in respect of cases selected for audit, loss cases and set-aside cases, finalization of complaints of existing taxpayers and any other functions assigned to Audit Division.

Sales Tax and Federal Excise

- All audits including desk audits /investigative / composite / post refund audits.
- Special Audit under Section 32-A.
- Determination and assessment of taxes/duties/liabilities and progress made on previous inspection/audit reports of Directorate of Internal Audit.

- Review of internal controls as applicable in the Organization.
- Conformity to prescribed procedures and maintenance of prescribed records.
- Any other function as may be assigned.

(ii) Enforcement & Collection Division

Income Tax

- Timely compliance of filing statutory returns and statements, charge of tax on defaulting withholding agents, collection and deduction of tax at source and issuance of exemption certificates.
- Timely disposal of internal and external audit observations/objections/paras.
- Proper communication of assessment orders/penalty orders and demand notices and giving appeal effect in the cases falling under the jurisdiction of Enforcement & Collection Division, rectification of orders, imposition of penalty under Part-X of Chapter-X, in the cases not related to audit u/s 177 of the Ordinance.
- Best judgment assessments u/s 121 of the Ordinance, except in cases under audit.
- Revision of assessments u/s 122A of the Ordinance, in respect of cases other than under audit.
- Provisional assessments u/s 122C of the Ordinance.
- Collection and recovery of taxes under Part-IV, Chapter-X of the Ordinance, and issuance of refund including refund adjustment, charge of additional tax and broadening of tax base.

Sales Tax and Federal Excise

- Accounting of tax receipts / tax collections.
- Review of maintenance of taxpayers' profile.
- Timely disposal of internal and external audit observations/objections/paras.

- Timely compliance of filing statutory returns.
- Identification of non/nil/short filers and appropriate action thereon.
- Charging of default surcharge and imposition of penalties, if required by law.
- Receipt and processing of returns, declaration, statements, profiles and issuance of various notices under the statutory provisions.
- Analysis and dissemination of information to taxpayers.
- Functioning of system soft-wares like STARR, STMS, ERS etc.
- Monitoring of collection and recoveries.
- Processing and issuance of refunds/rebates.
- Issuance of installation and consumption certificates etc. and various approvals under the law, involving any remission or concession of duty and taxes.
- Study / review of the cost of exemption/concession, their benefits to a specific sector / industries and their impact over the national economy.
- Any other function as may be assigned.

(iii) Legal Division

Income Tax

- Maintenance and processing of the records relating to follow up action/time limitations in respect of appeals before Commissioner (Inland Revenue) (Appeals) and Appellate Tribunal Inland Revenue (ATIR).
- Maintenance and processing of the records relating to follow up action/time limitations in respect of filing of references/petitions before the Hon'able High Courts and Supreme Court of Pakistan.
- Maintenance and processing of the records relating to follow up action/time limitations in respect of matters relating to the Federal Tax Ombudsman (FTO).
- Maintenance and processing of the records relating to follow up action/time limitations in respect of Alternate Dispute Resolution (ADR) matters.
- Study of functions and working of Review / ADR Committees.

- Maintenance and processing of the records relating to follow up action/time limitations in respect of representations before the President of Islamic Republic of Pakistan.

- Approval of Non-Profit Organization u/s 2(36) of the Ordinance.

- Matters relating to appointment of Departmental Representatives.

- Matters relating to appointment of Legal Advisors and their remunerations.

- Matters relating to Civil Suits, petitions, etc filed against the department or filed by the department.

Sales Tax and Federal Excise

- Defend appeals before Commissioner (Inland Revenue) (Appeals), institute and defend departmental appeals and references under Chapter-VIII of the Sales Tax Act, 1990 and Chapter-V of the Federal Excise Act, 2005.

- Maintenance and updating of record in cases of adjudication and adherence to the prescribed time frame in the issuance of show cause notices and assessment orders / orders-in-appeal.

- Review of all cases in which orders-in-original have been issued with a view to ascertain the legality/propriety of the same and follow up in these cases.

- Maintenance and updating of records, adherence to time frame in follow up actions, relating to the FTO.

- File/defend representation before the President of Islamic Republic of Pakistan.

- Maintenance and updating of records. Adherence to time frame in follow up actions, relating to appeals, Appellate Tribunals, High Courts and Supreme Court.

- Scrutiny of orders by appellate forums with a view to legally evaluate directions/decisions, indicating loss due to negligence of tax adjudication functionaries.

- Review of the defense offered by the respective Divisions in cases pending before various appellate forums in order to safeguard the State revenue.

- Performance review of legal counsels with specific recommendation to the FBR for their future nomination.

- Maintenance and processing of the records relating to follow up action / time limitations in respect of Alternate Dispute Resolution (ADR) matters.

- Study of the functions and working of Review / ADR Committees.
- Recovery of tax.
- Any other function as may be assigned.

(iv) Information Processing Division (Inland Revenue)

- Maintenance of physical and electronic records of taxpayers.
- Data entry of communication from Functional Divisions/Inland Revenue Authorities.
- Cross-matching of information collected from taxpayers and other sources and issuance of discrepancy reports to respective Divisions.
- Issuance of assessment records on demand to tax functionaries and maintenance of records in this regard.
- Receipt of communication from Functional Divisions and other Inland Revenue Authorities for service / process.
- Management of record and creation of the data base of taxpayers.
- Receipt and dispatch of information and record from and to other Divisions within the RTO / LTU or any other organization.
- Any other function related to record and information processing.

(v) Taxpayers' Facilitation & Human Resource Management Division (Inland Revenue)

- Receiving of returns, statements, statutory notices, documents, applications from taxpayers, mail from other Inland Revenue authorities.
- Receiving of tax payment receipts (Challans) from banks, and all outside communications.
- Sorting and dissemination of information, documents, returns, statements and mail to concerned quarters.
- Communication of assessment orders/penalty orders to taxpayers.

- Guidance to taxpayers in indirect tax matters.
- Education of taxpayers on new procedures as prescribed by FBR.
- Redress of grievances and providing assistance.
- Any other function falling under the tax facilitation work.
- Maintenance of employees' profiles and personal files.
- Matters relating to training of employees.
- Finalization of disciplinary proceedings and allied matters.
- Matters relating to posting, transfer, appointment and promotion of employees including allied matters like seniority issues etc.

Method of Inspection:-

The following procedure is being followed by the inspection team comprising Additional Director and his supporting staff in conducting an inspection:-

(1) The inspection authority intimates to the concerned field officer in LTUs/RTOs regarding inspection schedule and visits the said RTOs/LTUs to discuss the inspection work plan.

(2) The requisition of MPR/performance data and record of cases is made by the inspection authority followed by access to all requisite information and relevant record including computerized record, diskettes, floppies, hard discs available in the office.

(3) The inspecting authority after completion of initial scrutiny communicates draft observations on daily basis to the respective officer before finalization of inspection report.

(4) The respective taxation officer is required to respond within seven (7) days to settle the observations.

(5) Replies of the officers in charge are considered by the inspecting authorities before the draft notes are incorporated in the inspection report.

(6) Final inspection notes are serialized and incorporated in the inspection report along with the prescribed format on completion of the inspection work according to the method prescribed. The inspection report under the signature of inspection authority is delivered to the respective taxation officer within 15 days of the receipt of reply from the said officer, with copies to Chief Commissioner, LTUs/RTOs and Commissioner of the respective Division.

(7) The Director then forwards a copy of inspection report to the Director General of Internal Audit (Inland Revenue) along with his comments and the inspection control format.

(8) Year-wise computerized inspection control record is maintained in the office of each Director.

Follow up action:-

In order to settle objections or comments made in each serialized note of the inspection report and to retrieve the loss of revenue, if any, follow up action is taken independently at each level as under:-

i. The Deputy Director/Assistant Director/Extra Assistant Director pursues the matter with the respective officer of the field formation after the delivery of inspection report and furnishes compliance report within 30 days.

ii. The Additional Director takes cognizance of the unsettled notes on the basis of follow up report of the Deputy Director/Assistant Director/Extra- Assistant Director and takes up the matter with the respective Additional Commissioner to ensure compliance within 10 days. In case the matter is not resolved, the Additional Director reports the matter to the Director, Internal Audit (Inland Revenue) under intimation to the respective Commissioner.

iii. The Director, Internal Audit (Inland Revenue) takes up the matter with the respective Commissioner to ensure resolution within 10 days. If the matter remains unresolved, the Director takes up the matter with the Chief Commissioner, RTOs/LTUs, as the case may be, and furnishes report to the Director General of Internal Audit (Inland Revenue) under intimation to the respective Chief Commissioner, RTOs, LTUs highlighting measures adopted for follow up and disposal of the matter.

iv. The Director General of Internal Audit (Inland Revenue) then allows 15 days for compliance to the respective Chief Commissioner, RTOs/LTUs.

v. In case the compliance is not made after the expiry of 15 days, the Director General of Internal Audit (Inland Revenue) takes up the matter with the Chief Commissioner, RTOs/LTUs, and the respective Member or refers the matter to the Chairman, FBR as considered appropriate.

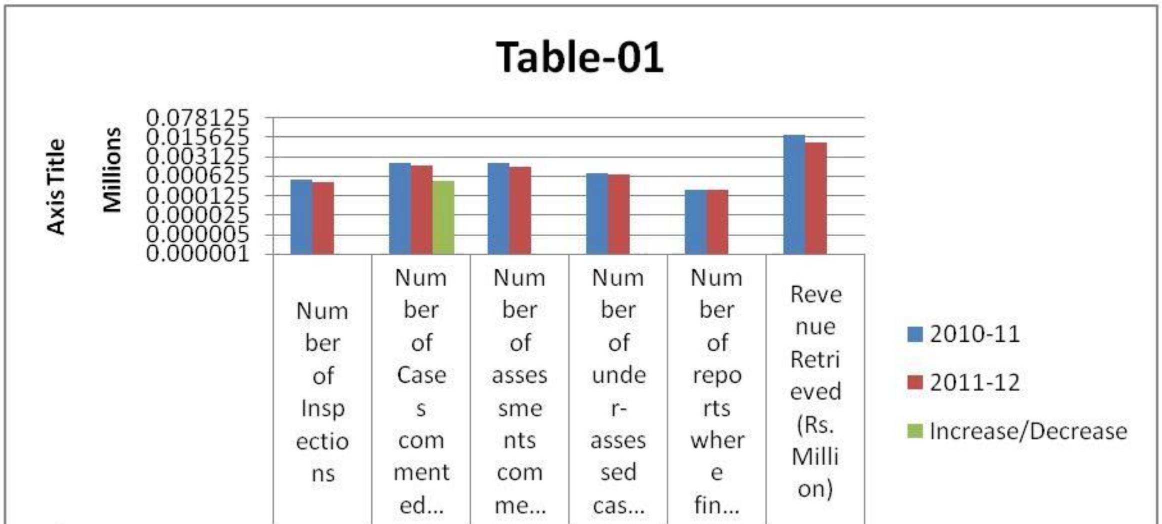
vi. The Director General of Internal Audit (Inland Revenue) issues necessary instructions for follow up of the matter to any of subordinate offices as considered appropriate.

vii. Final compliance in respect of each inspection report is reported to the Director General of Internal Audit (Inland Revenue) on prescribed format as soon as possible but in no case later than sixty (60) days from the date of delivery of inspection report to the respective field officer in LTUs/RTOs.

Facts and Figures on Performance of Inspection Function during the Year 2011-12

1. Regular/Special Inspection Performance in Comparison with Preceding Year

Table-01				
S. #	**Description**	**2010-11**	**2011-12**	**Increase/ decrease**
1.	Number of Inspections.	493	385	-108
2.	Number of cases commented upon	1881	1472	-409
3.	Number of assessments commented upon.	1804	1444	-360
4.	Number of under-assessed cases.	818	736	-82
5	Number of reports where final/partial action completed by the taxation officer	209	198	-11
6.	Revenue retrieved (Rs. Million)	19040.760	10590.600	- 8450



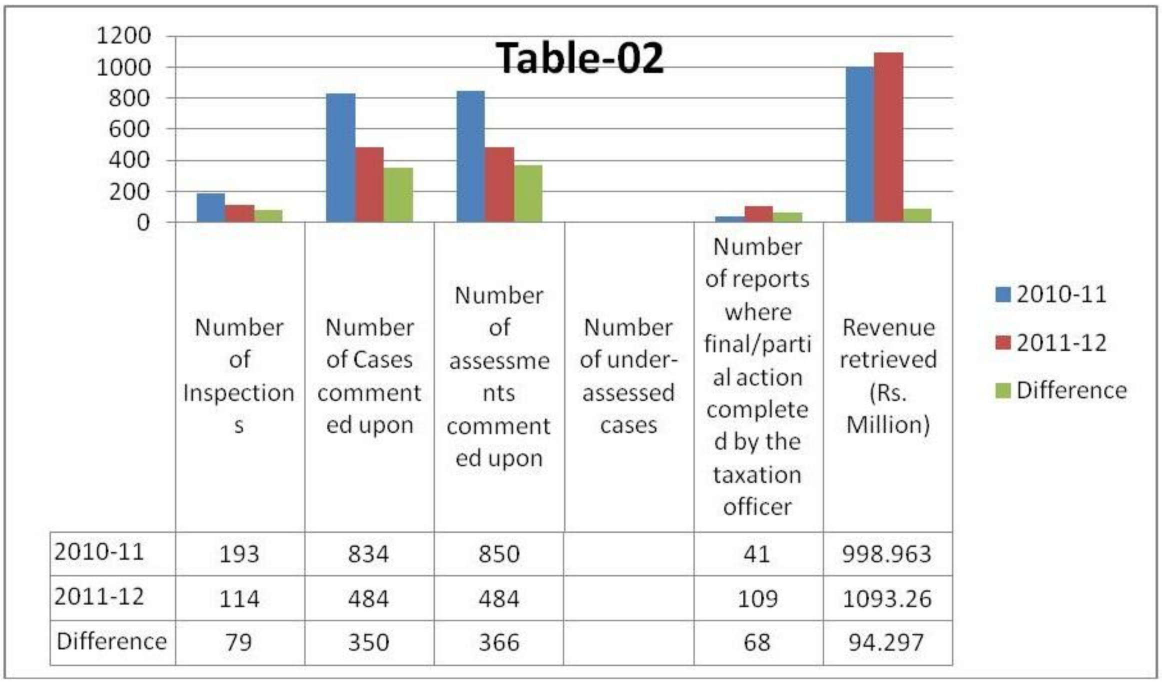
	Number of Inspections	Number of Cases commented...	Number of assessments comme...	Number of under-assessed cas...	Number of reports where fin...	Revenue Retrieved (Rs. Million)
2010-11	493	1881	1804	818	209	19040.
2011-12	385	1472	1444	736	198	10590.
Increase/Decrease	-108	409	-360	-82	-11	-8450

Table-1 depicts the number of inspections carried out during the financial year 2011-12 in comparison with the immediately preceding financial year 2010-11. The above comparison reveals that the number of inspections conducted for the year 2011-12 has decreased to 402 from 385 conducted during the year 2010-11. Similarly, the number of inspection reports where follow up action has been completed has also decreased from 209 to 198 for the year 2011-12. Loss of revenue of Rs. 10590.600 million pertaining to Inspection has been retrieved during the year 2011-12 which is less than the loss of revenue retrieved during last year.

The reason behind decrease in number of inspections conducted is that the inspections are conducted by the Additional Directors (BS-19). During the period under reference 9 posts of the Additional Directors (BS-19) out of sanctioned strength of 16 remained vacant. Non-availability of the Additional Directors adversely affected inspection work of the Directorate of Internal Audit (IR), Southern Region, Karachi where 2 Additional Directors only remained posted throughout the financial year 2011-12 against the sanctioned strength of 7. Similarly, 2 posts of Additional Directors at Gujranwala and Multan in the Directorate of Internal Audit (IR), Central Region, Lahore also remained vacant throughout the period under review. The Directorate of Internal Audit (IR), Northern Region, Islamabad also had to suffer due to shortage of two officers of (BS -19) at Rawalpindi and Abbottabad. This office has repeatedly apprised the Board regarding shortage of officers and made several written requests for posting of officers. It is pertinent to mention that against all such short comings and odds, there is a sufficient increase in overall revenue retrieval through inspection and audit during the year 2011-12.

2. Regular Inspection Performance in Comparison with 2011-12 by Northern Region, Islamabad.

Table-02				
Sr. No.		**2010-11**	**2011-12**	**Difference**
1	Number of inspections	193	114	- 79
2	Number of cases commented upon	834	484	-350
3	Number of assessments commented upon	850	484	-366
4	Number of under-assessed cases	-	-	-
5	Number of reports where final/partial action completed by the taxation officer	41	109	68
6	Revenue retrieved (Rs. Million)	998.963	1093.260	94.297



The above table reveals the performance of Northern Region for the year 2011-12 in comparison with the financial year 2010-11. During the year under consideration, the number of inspections carried out has decreased to 142 from 193 conducted for the year 2010-11. However, he number of inspection report finalized has increased to 109 for the year 2011-12 as compared to 41 finalized for the last year despite the shortage of two Additional Directors in the Region throughout the year and frequent jurisdictional changes in the relevant RTOs. Stringent follow up of major cases was ensured which resulted in retrieval of loss of revenue of Rs. 1093.260 million this year in comparison with the retrieval of loss of revenue at Rs. 998.963 million in the year 2010-11 which shows 1.09 times increase.

3. Regular/Special Inspection Performance in Comparison with Preceding Year for Central Region, Lahore.

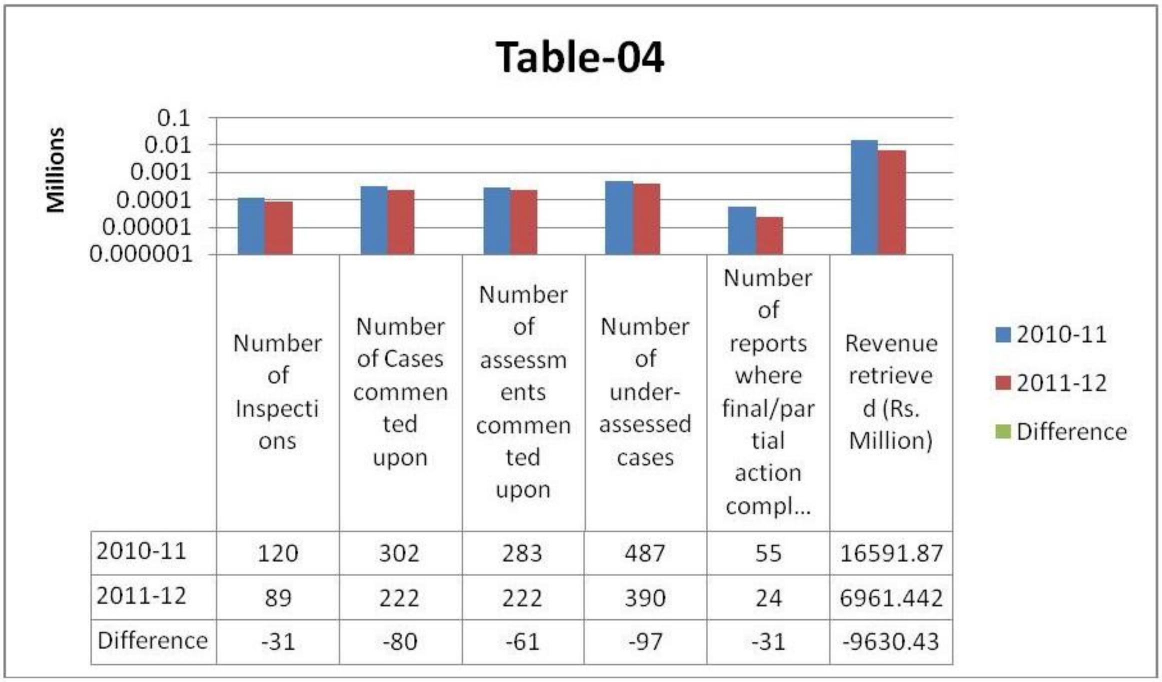
Table-03				
Sr. No.		**2010-11**	**2011-12**	**Difference**
1	Number of inspections	180	182	2
2	Number of cases commented upon	745	766	21
3	Number of assessments commented upon	671	738	67
4	Number of under-assessed cases	331	346	15
5	Number of reports where final/partial action completed by the taxation officer	113	65	-48
6	Revenue retrieved (Rs. Million)	1449.922	2535.898	1085.976

Table-03 above depicts the performance of the Central Region, Lahore during the year 2011-12 in comparison with the financial year 2010-11. During the year 2011-12, 182 inspections have been conducted by the Additional Directors as compared to 180 for the last year. The Central Region's contribution to the total number of inspections conducted is 45.27%. The number of cases of under-assessment and tax evasion has increased to 346 in the year 2011-12 as compared to 331 for the last year. The number of reports where final/partial action completed by the Taxation Officers, as a result of follow up action, stood at 65 as compared to 113 for the preceding year. However, loss of revenue of Rs. 2535.898 million has been retrieved during the year 2011-12 which is 1.74 times the revenue retrieved during the year 2010-11 at Rs. 1449.922 million. The performance in this area is excellent.

4. Regular Inspection Performance in Comparison With 2010-11 for Southern Region, Karachi.

Table-04

Sr. No.		2010-11	2011-12	Difference
1	Number of inspections	120	89	-31
2	Number of cases commented upon	302	222	-80
3	Number of assessments commented upon	283	222	-61
4	Number of cases under-assessed cases reported	487	390	-97
5	Number of reports where final/partial action completed by the taxation officer	55	24	-31
6	Revenue retrieved (Rs. Million)	16591.875	6961.442	-9630.433



	Number of Inspections	Number of Cases commented upon	Number of assessments commented upon	Number of under-assessed cases	Number of reports where final/partial action compl...	Revenue retrieved (Rs. Million)
2010-11	120	302	283	487	55	16591.87
2011-12	89	222	222	390	24	6961.442
Difference	-31	-80	-61	-97	-31	-9630.43

Table-04 above reflects the performance of Southern Region, Karachi during the year 2011-12 in comparison with the financial year 2010-11. During the year under reporting 89 inspections have been conducted by the Additional Directors as compared with 120 for the last year. The number of cases of under-assessment and tax evasion has decreased to 390 during the year 2011-12 as compared with 487 last year. The number of inspections commented upon has also decreased. The decrease in number of inspections conducted is due to the shortage of Additional Directors, officers and staff as well as frequent jurisdiction changes and lack of access to records.

Despite all odds, hectic efforts and stringent follow up were made with special focus on major cases. As a result, loss of revenue of Rs.6961.442 million has been retrieved during the year 2011-12 which is less the loss of revenue retrieved out of inspections in the year 2010-11. The number of inspections commented upon has decreased due to the shortage of Additional Directors, officers BS-17/18 and staff.

5. Comparative Analysis of Revenue retrieved (Region-wise)

Table-05									
Sr. No	**Region**	**Regular**		**Directors'**		**Special**		**Total**	
		2010-11	2011-12	2010-11	2011-12	2010-11	2011-12	2010-11	2011-12
1.	Northern	335.154	1091.859	243.795	110.722	420.014	1.421	998.963	1093.260
2.	Central	1172.620	1434.000	-	-	277.302	1101.898	1449.922	2535.898
3.	Southern	16591.875	6957.706	-	-	2120.546	3.736	18712.421	6961.442
	Total	**19433.189**	**9151.463**	**243.795**	**110.722**	**2817.862**	**1439.157**	**22494.846**	**10590.600**

The Region-wise comparison of revenue retrieved reveals that the Southern Region, Karachi has shown decrease in the revenue retrieved as compared with the revenue retrieved during the year 2010-11. The decrease in loss of revenue retrieved was due to the shortage of Additional Director in 5 Ranges of the Southern Region, Karachi. However, the Northern Region, Islamabad and the Central Region, Lahore have shown progress as their retrieved revenue during the year 2011-12 is 1.09 and 1.74 times respectively higher than the revenue retrieved during financial year 2010-11.

6. Pending Inspection Reports as on 30-06-2012

Table-06					
S. No.	**Region (Including reformed Units)**	**Regular Inspection**	**Inspections by Directors**	**Special Inspection**	**Total**
1	Northern Region	345	05	169	519
2	Central Region	355	-	83	438
3	Southern Region	381	-	28	409
Total		**1081**	**05**	**280**	**1366**

Table-06 above depicts the Region-wise breakup of pendency of inspection reports. As on 30.6.2012, 1366 inspection reports are lying pending as compared with 1125 for the last year. The increase in pendency of the inspection reports is due to the reason that a large number of regular and special inspections have been carried out and issued to the respective field formations during the year 2011-12. Retrieval action in most of the current inspection reports has not been finalized by the respective officers within the stipulated time. It has been observed that the field offices have not been able to dispose of the inspection reports within the prescribed time despite the fact that hectic follow up efforts have been made at all levels. Focal persons were appointed and follow up meetings were also conducted at Director's General/ Chief Commissioner's level.

The following reasons have also contributed to the increase in pendency:-

a. Shortage of Additional Directors, officers (BS-17/18) and staff.

b. Frequent jurisdiction changes and lack of access to records.

INTERNAL AUDIT (EXPENDITURE)

The objectives of Internal Audit (Expenditure) are to conduct and report fair, independent an impartial audit of all expenditures of the Inland Revenue Service. The Directorate General of Internal Audit (Inland Revenue) carries out Expenditure Audit in respect of offices of Inland Revenue with the purpose to enforce proper maintenance of expenditure record and check arithmetic accuracy of prescribed books of accounts and financial statements, detection and prevention of errors and mistakes by omission or commission in the accounts. The basic aim of Expenditure Audit is to scrutinize the expenditure incurred by the offices of Inland Revenue. The logic behind this exercise is to impart guidance to Drawing & Disbursing Officers and sanctioning authorities to abide by rules given in General Financial Rules (GFR). Further, the Audit assists the field officers in improving internal controls and maintenance of necessary record for countering audit objections by External Audit.

AREAS OF INTERNAL AUDIT (EXPENDITURE)

Income Tax, Sales Tax and Federal Excise.

Audit (Expenditure) is conducted in respect of the following areas:

- Monthly/Annual reconciliation of expenditure with AGPR.
- Cash book.
- Budget Control Register.
- Stores/Stock Register.
- Stationery Register.
- Log book of vehicles.
- Telephone Register.

- Long term/short term advances Register.
- Photocopies Register.
- Consumable stores Register.
- Newspaper Register.
- TA/DA Register.
- Service books of the officials.
- Vouchers, contingent bills, T.A/DA Bills, Bills of advances etc.
- History and particulars of Machinery & Equipment (Fax, Photocopiers, Computers etc.)
- Economical and efficient use of resources.
- Embezzlement in expenditure.
- Proper deduction, collection and deposit of Income Tax, Sales Tax and Federal Excise Duty.
- Maintenance of Bank Account in the name of DDO or his personal account, if any.
- Follow up of previous years' Audit Reports.
- Checking of Establishment Bills.
- Leave Accounts of the staff.
- Travelling Allowance Bills of officers/staff.
- Medical reimbursement Bills of retired/in service officers/staff.
- Contingent paid vouchers.
- Monthly progress report.
- Registers/lists pertaining to weeding of old record.
- Casual leave account.
- Register of PDP.
- Auction sale account.
- Stock verification record.
- Attendance registers.
- Sanctioned strength of officers/staff and Disposition lists.
- Postage stamp registers.
- Cash imprest.
- Over time allowances registers.

- Pension cases (Final bill payment)
- Dead stock registers.
- Register of advances i.e. HBA/MCA etc.
- GP Fund deductions etc.
- House requisition registers.
- Index register of cases.
- Tender Register.
- Any other records as are prescribed under the law/rules/procedures.

The Directorate General conducted internal audit (expenditure) of the offices of Inland Revenue during the year under reporting and pointed out various deficiencies/ irregularities. The exercise has been helpful in capacity building of the departmental officers/officials regarding internal controls.

MAJOR ACHIEVEMENTS

The following cases are indicative of the performance of the Directorate General where sizeable amount of lost revenue has been retrieved on the basis of detection of discrepancies by the Inspection Authorities through inspection reports.

SOUTHERN REGION, KARACHI

S. #	N.T. #	NAME OF TAXPAYER	TAX YEAR	ISSUE INVOLVED	LOSS OF REVENUE RETRIEVED
1	0507428	M/s. Sandak Metal.	2006	• Wrong claim of operating expenses. • Wrong claim of depreciation allowance. • Receivable against stores were not offered to tax.	404.153 (M)
2.	0709959	M/s. Kufpee Pakistan (BV). Karachi.	2006	• Incorrect application of tax rates. • Inadmissible provision of Exchange Loss. • Inadmissible provision of Unwinding Discount. • Wrong claim of expenses.	112.164 (M)
3	0709838	M/s. Baluchistan Onyx Development Corporation Ltd.	2009	• Non deduction of tax u/s 153 of the Income Tax Ordinance, 2001 on the payment made by the Taxpayer under various heads.	21.935 (M)

CENTRAL REGION, LAHORE

S. #	N.T. #	NAME OF TAXPAYER	TAX YEAR	ISSUE INVOLVED	LOSS OF REVENUE DETECTED/ RETRIEVED
1	1913011-2	M/s. Japan Power Generation, Ltd	2010	• Wrong claim of business losses.	161.001 (M)
2.	1352104	M/s. Kashmir Feeds Limited,	2008	• Default of Withholding Tax provisions.	86.948 (M)
3.	0801297	M/s Volvo Pakistan Limited, Lahore.	2006	• Excess claim of carry forward losses. • Excess claim of expenses.	75.837 (M)
4.	1436951	M/s. Roshan Packages (Pvt), Ltd.	2007	• Default of Withholding Tax provisions.	60.124 (M)
5.	0711003	M/s JDW Sugar Mills Ltd.	2011	• Wrong adjustment of refund.	48.013 (M)
6.	1938848	M/s TU Plastic Inds. (Pvt) Ltd.	2008	• Default of Withholding tax provisions.	32.847 (M)
7.	1991470	M/S Olympia Chemicals Ltd.	2010	• Wrong adjustment of refund.	23.808 (M)

NORTHERN REGION, ISLAMABAD

S. #	N.T. #	NAME OF TAXPAYER	TAX YEAR/ A.Y	ISSUE INVOLVED	LOSS OF REVENUE RETRIEVED
1.	0801599-6	Pakistan Telecommunication, Ltd.	2011 2012	• Short payment of Federal Excise Duty.	2782.660 (M)
2.	2046004	M/s. Telenor Pak Limited	2007	• Addition on account of unapproved staff provident fund. • Provision for bad debts disallowed.	503.546 (M)
3.	0712126	Shifa International	2005	• Income Tax paid on income instead of turnover. • Income from LAB, X-Rays, CT Scan and MRI was not declared.	95.699 (M)
4.	0757432	M/s. BGP Pakistan International	2010	• Non-payment of WWF	77.073 (M)
5.	1161581-8	M/s. Pakistan Telecom Mobile	2005 2006 2007	• Claim of bad debts disallowed through amendment u/s 122 (5A) of the Income Tax Ordinance, 2001	49.344 (M)
6.	0000290	FS Tobacco (Pvt) Limited.	99-2000 to 2001-02	• Short declaration of supplies	43.852 (M)
7.	0070000	Bahria Town	98-99	• Tax not charged on receipts. • No tax deduction made on payments.	15.023 (M)

SPECIAL INTIATIVES.

The Directorate General of Internal Audit (IR) launched special initiatives by conducting special inspection in respect of Sales Tax which resulted in detection of huge loss of revenue. Special Inspection reports have been forwarded to the respective LTUs/RTOs for remedial action as per law. A few examples are given below:-

1. M/S LAHORE ELECTRIC SUPPLY COMPANY LIMITED.

M/s Lahore Electric Supply Company Limited collected Rs. 6573.364 (M) from the Steel Melters and Re-rollers under Chapter XI of the Sales Tax Special Procedure Rules, 2007 and claimed illegal adjustment of Input Tax against this tax collection. Thus, M/s. Lahore Electric Supply Company Limited has paid short Sales Tax to tune of Rs. 6573.364 (M).

2. M/S NATIONAL TRANSMISSION AND DISPATCH COMPANY LIMITED.

M/s. National Transmission and Dispatch Company Limited has declared sales in the return of total income under the Income Tax Ordinance, 2001 at Rs. 594293.862 (M) whereas sales as per Sales Tax returns (July, 2009 to June, 2010) have been declared at Rs. 436071.262 (M). Thus, the said registered person has suppressed sales/supplies amounting to Rs. 158222.600 (M) and resultantly suppressed sales tax amounting to Rs. 25315.616 (M).

3. M/S GEPCO AND STEEL MELTERS GUJRANWALA.

M/s. Gujranwala Electric Power Company Limited collected Rs.1965.880 (M) as Sales Tax according to Rule 58 H, Chapter-XI of the Sales Tax Special Procedure Rules, 2007 from Steel Melters and adjusted the same amount of Sales Tax against their input tax. This was found in violation of section 7 (1) read with sub-section 20 and 41 of section 2 of Sales Tax Act, 1990. The said collection of Sales Tax @ Rs. 6/- per Electricity Unit from Steel Melters does not come within the ambit of “Output Tax” because it was not the supply of goods by the GEPCO against the Sales Tax collected.

4. **M/S. MULTAN ELECTRIC POWER COMPANY.**

M/s. Multan Electric Power Company has declared as per income tax return total net sales at Rs. 95,010,316,149/- and sales tax @ 17% comes to Rs. 16,151,753,745/- whereas as per sales tax data total sales have been declared at Rs. 61,955,815,823/- and paid sales tax at Rs.10,559,218,166/-.The difference of tax paid and to be paid comes to (Rs. 16,151,753,745/- Rs. 10,559,218,166/-)= Rs.5,592,535,579/- which is recoverable under section 11, 36 and 48 of the Sales Tax Act, 1990 along with default Surcharge u/s 34 and penalty u/s 33 of the Sales Tax Act, 1990.

Further, it has been observed that M/s. Multan Electric Power Company has collected sales tax Rs.64,213,985 (M) from the Steel Melters and Re-Rollers under Chapter-XI of the Sales Tax Special Procedure Rules, 2007 and claimed illegal adjustment of input tax. This was found in violation of section 7 (1) read with sub-section 20 and 41 of section 2 of Sales Tax Act, 1990. The said collection of Sales Tax @ Rs. 6/- per Electricity Unit from Steel Melters does not come within the ambit of “Output Tax” because it was not the supply of goods by the MEPCO against the Sales Tax collected. This tax is merely being collected by the said registered person on behalf of the Federal Board of Revenue as a final and net discharge of tax liability by Steel Melters and Re-Rollers. Thus, M/s. Multan Electric Power Company cannot adjust its input tax against the final tax paid through Electricity Bills by Steel Melters and Re-Rollers.

5. **M/S. M.H PLASTIC INDUSTRIES, LAHORE.**

Refund in aggregate of Rs. 133.806 (M) through 30 RPOs has been issued in the case of M/s. M.H. Plastic Industries, Lahore during the tax period from April, 2010 to

June, 2011. All the above said refunds were issued subject to Post Refund Audit but as per available record till the time of inspection no such audit was conducted. The above said refunds were issued out of a total claim of Rs. 128.345 (M) for the tax period April, 2010 to June, 2011. Further, discrepancy has also been pointed out from the analysis of consumption statement in wastage claimed by the registered person ranging between 5.63% to 9.43%. Similarly, huge variation has been noticed in value addition declared by the registered person ranges between 4.65% to 26%. It has also been observed that there is huge variation in sale price offered to registered and un-registered persons. The case has been recommended for investigative audit from July 2009 to December, 2011.

6. **M/S WAPDA.**

For the tax period July, 2006 to June, 2011 M/s. WAPDA has declared supplies worth billion of rupees in the Sales Tax returns but almost 'nil' bank payments were made with continuous carry forward. The said registered person has declared purchases and supplies made to M/s. WAPDA and filed Nul (No Business Activity) returns for the period from July, 2009 to November, 2009. On the other hand M/s LESCO, M/s. FESCO, M/s. GEPCO and M/s. MEPCO claimed input tax adjustments amounting to Rs. 12158.702 (M) against supplies shown from WAPDA but WAPDA has shown 'nil' supplies during the corresponding tax periods. In addition, M/s. Wapda has collected sales tax on arrear but did not deposit said amount on cut off date i.e. August, 2006.

It is pertinent to mention that special initiatives of audit are under-way in some important cases. The Chief Commissioners are requested to support and facilitate the process by providing basic logistic support wherever necessary and needed to Internal Audit officers / officials.

GLIMPSES OF EVENTS

Director General with Officers and Staff

Mr. Muhammad Akram Tahir
Director, Central Region, Lahore.

Mr. Shaukat Mehmood, Director,
Internal Audit (IR), Nothern Region, Islambad.

Mr. Javed Iqbal Mirza,
Ex-Director Southern Region, Karachi

Mr. Raza Munawar,
Ex-Director, Central Region, Lahore.

Syed Ghulam Abbas Kazmi, Secretary
Internal Audit (IR), Islamabad.

Mr. Nawab Khan, Additional Director,
Internal Audit (IR), Peshawar

Mr. Abdul Hameed, Additional Director
Internal Audit (IR), Rawalpindi

Muhammad Alam Zaib Khan, Second Secretary
Internal Audit (IR), Islamabad.

Mr. Arshad Rehmani, Accounts Officer
Internal Audit (IR), Islamabad

Director, Northern Region, Islamabad with his officers

**Ms. Sajida Kausar, SA to Director,
Northern Region, Islamabad**

Mr. Hassan Abbas, SA to Director,
Southern Region, Karachi

Mr. Hassan Abbas, SA and other officers of,
Southern Region, Karachi

Ms. Kiran Sarfraz, Secretary
Internal Audit (IR), Camp Office, Lahore.

Mr. Behzad Anwar, Deputy Director
Internal Audit (IR), Camp Office, Lahore.

Mr. Ijaz Ahmad, Second Secretary
Internal Audit (IR), Camp Office, Lahore.

Officers and Staff of
Diectorate General, Internal Audit (IR), Camp Office, Lahore.

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Director General, Internal Audit (Inland Revenue) in meeting with
Mr. Muhammad Anwar Goraya, Chief Commissioner Inland Revenue,
Regional Tax Office, Karachi.

Director General, Internal Audit (Inland Revenue) in meeting with
Khawaja Tanveer Ahmad, Chief Commissioner Inland Revenue,
Regional Tax Office-II, Karachi.

Director General, Internal Audit (Inland Revenue) in meeting with
Malik Abdul Samad, Chief Commissioner Inland Revenue,
Regional Tax Office-III, Karachi.

Ms. Sameera Yasin, Director General, Internal Audit (Inland Revenue)
with Mr. Rehmatullah Khan Wazir, Chief Commissioner
Inland Revenue, Large Taxpayers Unit, Karachi and officers.

Ms. Laila Ghafoor, Additional Director
Internal Audit (Inland Revenue),
Central Region, Lahore.

Ms. Irum Sarwar, Additional Director,
Internal Audit (Inland Revenue), Faisalabad.

TAX REFORMS

By:
Abdul Hameed,
Additional Director, Internal Audit
Inland Revenue,
Rawalpindi.

Tax Reforms have been introduced in tax regime with an objective to improve the present system and to bring it at par with the existing successful models in developed countries to achieve optimum results/goals.

Restructuring of Department is an essential component of tax reforms. The direct and indirect taxes have been merged in Inland Revenue Service (IRS) and all record of income tax and sales tax has been assembled at one place under one officer in Regional Tax Offices (RTOs) and Large Taxpayer Units (LTUs). Thus one window operation has been initiated to obtain better results. The co-operation of IMF and World Bank is worth mentioning in extending financial assistance. The specialized functional units have come into existence e.g. Audit Wing, Enforcement, Legal Wing, IP Wing, and Tax Facilitation Divisions. The reforms started in January, 2005 with the launching of project under the name TARP (Tax Administration Reform Project).

TAX ADMINISTRATION REFORM PROJECT

- The project was launched by Government of Pakistan under the name "Tax Administration Reform Project" under Federal Board of Revenue in collaboration with World Bank (IDA Credit No. 4007), International Bank for reconstruction and Development (IBRD) and department for International Development (DID) vide grant No. 54392F for arranging finances for reforms in progress in FBR.
  The project started in January, 2005 with the closing date of 31st December, 2009 which was later on extended upto December, 2011.

- The project was to be financed from Foreign Donor Agencies and also from Government of Pakistan at agreed percentage from its own resources. The major contribution was from Donor Agencies.

PROJECT OBJECTIVES AND ITS RELATIONSHIP WITH SECTORAL OBJECTIVES

- To increase revenue and improve Tax GDP ratio.
- To restructure FBR along Functional Line and develop a highly trained and motivated man force motivated to develop a modern efficient revenue administration.
- To increase voluntary compliance with tax law.
- To increase use of information technology to promote self assessment and prudent audit selection.
- To design and deliver fair, effective enforcement mechanisms responding to changes in the environments.
- To develop effective working relationship with taxpayers and other Government Departments.
- To increase revenue collection through broadening of tax base and to eliminate revenue leakage.
- To bring taxpayers in tax net by introducing effective self assessment audit.
- To enhance productivity, efficiency, transparencies, job satisfaction and integrity of FBR employees through incentive based salary structure and extensive training program.

MAJOR AREAS OF EXPENDITURE

The implementation plan revolved around major areas of expenditure incurred by TARP.

i. Civil Works refurbishment.
ii. Hardware.

iii. Software
iv. Technical assistance.
v. Automobiles.
vi. Trainings.
vii. Project management cost.

EFFECTS OF REFORMS

Positive Outcomes.

1. Restructuring of department and availability of all sort of information/record of taxpayer at one place.
2. Specialized Units/Wings.
3. Minimum contact with taxpayers.
4. Self assessment scheme.
5. Automation of record.
6. Better working environment.
7. Facilitation Centers for taxpayers.
8. Documentation of Economy.
9. Increase in salary and provision of vehicles.
10. Monitoring of withholding taxes.
11. Mandatory/maintenance of record by taxpayers.
12. Intelligence and Investigation Department.

HAVE WE ACHIEVED DESIRED OBJECTIVES?

The reforms were envisaged in 2005 and stand completed in December, 2011. With the financial and technical aid of IMF and World Bank, the government of Pakistan has vigorously implemented reforms in Pakistan Tax System. The tax service has been renamed as Inland Revenue Service including Income Tax, Sales Tax and Federal Excise. Large Taxpayer Units, Regional Tax Offices and Model Custom Collectorates have been established in big cities of Pakistan. Revenue targets have been enhanced on yearly basis in the eve of restructuring of department. All data has been computerized and emphasis is on computerized data instead of manual registers.

On the other hand, we have not yet been able to implement policy in true letter and spirit. Lack of political will is visible. We have not yet been able to implement GST Scheme. Although, we have extended co-operation towards taxpayers by trusting his declaration of income and reposing full confidence in his version yet the response of taxpayers in depositing due taxes and declaring true particulars of income is lukewarm. The revenue has not increased as envisioned. The incidence of return filing by taxpayer has shown declining trend.

FLAWS OF REFORMS

The Tax Reforms were initiated in good faith with the objective to enhance revenue collection by reposing more confidence in taxpayer and introducing self assessment scheme but the desired results are yet to be achieved. The flaws of scheme are discussed hereunder:-

1. More reliance on indirect tax collection than on direct tax collection.
2. Increase in number of non-filers of returns.
3. Failure to discover and book new taxpayers.
4. No broadening of tax base.
5. Lack of directional training.
6. Merger of income tax with sales tax with no proper training.
7. Utilization of training fund on FBR (HQ) officers instead of field formations.
8. Slow automation process.
9. Lack of co-ordination of functional groups (like audit, enforcement, IP, TFD and legal).
10. Slow recovery of arrears and assessment demand.
11. Abolition of wealth tax.
12. Slow pace of utilization of computerized data/ discrepancies of sales tax/excise duty by field formation.

FLAWS IN TRAINING PROGRAMME

- The examination of accounts of TARP for the year 2008-09 revealed the following position. 72% officers (sent on foreign training) were posted at FBR HQ . Whereas only 24% from field formation were sent abroad.
- The share of officers posted at Directorate of Training and Research for foreign training was negligible and not a single officer was sent abroad from Internal Audit department.
- As regards utilization of fund for reforms, 87% of fund was utilized on officers posted at FBR HQ and 13% fund was utilized for field formations.
- It was noticed that some officers posted in FBR HQ were sent twice for training in the year 2008-09.
- Contractual employees were also sent for foreign training entailing expenditure to the tune of Rs. 2.420 (m). Such officers were also sent for training who were on deputation.
- FBR has sent abroad 143 officers from January, 2005 to June, 2009 spending an amount of Rs. 66.961 (m) on foreign training and Rs. 94.02 (m) on local training. This constitutes 32.62% only for allocated budget for training at Rs. 493.417 (m) in revised PC-I.
- 13.54% was spend on foreign training and 19.05% on local training of allocated grant.
- Out of 1600 officers, only 143 officers from January, 2005 to June, 2009 were sent on foreign training which is even less than 20% of total strength.
- The available un-utilized grant is 493.417 (m) was not utilized upto 30.06.2009 despite of the fact that reform project was going to conclude in 2011.

RECOMMENDATIONS

1. Proper co-ordination between various functional units of reforms.
2. Directional Training Programme for field officers.
3. Levy of tax on real estate and agriculture sector.
4. Allowances to be given on merit basis only.
5. Broadening of tax base.
6. To capture informal sector of economy in tax net.
7. To strictly enforce filing of returns and recovery of arrears and take positive measures as well.
8. To promote tax compliance culture through education, media and information technology.
9. To provide incentives and honour compliant taxpayer.
10. Universal acceptance of self assessment scheme followed by a very stringent audit backup.
11. To eliminate exemptions and allowances on investment introducing uniformity.
12. Despite launching of such an extensive reform package, various problems still continue to impede progress like narrow audit base, extensive jurisdictional changes “in accessibility to record” etc. The structural changes by FBR mainly pertain to renovation for existing building. Although we have shifted to e-filing but still sufficient data base has not been maintained for meaningful desk audit. It is high time to evaluate our reforms and instead of considering reforms merely a service to satisfy donor agencies, we should make reforms process a complete success.

Tax Culture in Pakistan

Kiran Sarfraz Khan
Secretary DG-Internal Audit

The term of "Tax Culture" is a comparatively new one in the nomenclature of tax history. A German Scholar, Birger Nerre of University of Hamburg defines and elaborates the term of Tax Culture by saying: *"A country-specific tax culture is the entirety of all relevant formal and* informal institutions connected with the national tax system and its practical execution, which *are historically embedded within the country's culture, including the dependencies and ties caused by their ongoing interaction".* Tax Culture was further elaborated by Armin Spitaler (1954) in his articles as *"Taxation is influenced by economic, social, cultural, historical, geographical, psychological and further differences prevailing in the individual countries and their societies".*

The phenomenon of Tax doesn't exist in any society in vacuum or otherwise it isn't something abstract. This is rather a concrete phenomenon, which is rooted in the very fiber of the society. The Tax Culture of a country or community isn't the outcome of any single factor rather it is the outcome of several closely interlinked features. We all are aware of the fact that tax is something which is widely and intensely disliked by the public. This is not only the case with Pakistan but this syndrome is very much there in rest of the world including country like U.S. This is mainly due to the fact that taxes are economic burden of an obligatory nature from which the taxpayer does not derive a direct, personal and immediate benefit.

It must also be taken into consideration that financial laws for a backward country like Pakistan are much complicated for the taxpayers as well as tax-collectors. Before proceeding further, this would be advantageous to have a cursory look at the historical development of Income-Tax law to date.

- The first Income Tax Act was promulgated in 1860. This was designed after the scheme of taxation observed in United Kingdom and most important it was a deliberate effort to end the budgetary deficit following the war of independence of 1857 in the sub-continent.
- This Act lasted five years as it was completely withdrawn followed by a period of two years when there was no Income Tax Law in force. However, this was re-enforced with a new title of The License Tax Act 1867.
- Subsequent developments gave rise to a new Income Tax Act in 1886.
- Later on Income Tax Act of 1918 was promulgated and applied accordingly.
- Income Tax Act 1922 was promulgated and the same was adopted by our country after winning independence in the year 1947.
- This Act remained in the field to be replaced only by the Income Tax Ordinance 1979.

- Income Tax Ordinance 2001 was introduced by the Government. It is worth mentioning that before the date of its enforcement, the government made as many as 322 changes in it through Finance Ordinance 2002, concept.

  Almost similar is the case with other financial laws of this country.

  In my opinion there are number of factors serving as hurdles in the evolution of tax culture of our country like-

  (1) Mistrust about use of Tax Money

  On the one hand there is very insignificant population which is in the tax net while on the other, there is a feeling of mistrust and obscurity among the taxpaying community against the government as to the fact that the funds generated out of their taxes are not properly utilized rather they are mishandled and wasted.

  (2) Tax Illiteracy

  According to official statistics, the literacy rate (defined as people who can merely read or write their names) is not more than 36%. When this is the state of literacy in our country, we can very well judge that to what extent our population or even the taxpayers would be equipped with the understandings of our tax code.

  (3) Complexity of the Financial Laws

  Keeping the overall low level of literacy among the population aside, the problem of proper understanding of the tax code due to its intricacy and complexity becomes enormous and manifold. This has been the common characteristic of our tax culture that there happen frequent and haphazard changes in the tax code of the country as discussed above.

  (4) Mis-declaration of Income

  Honest declaration of income/wealth plays the most pivotal role in dispensing any financial liability. I must concede that we as a nation have not been loyal and honest enough to declare true facts. Rather it is matter of pride on individual as well as collective level to befool the state machinery.

  (5) Broadening the Base of Taxpaying population

  Total number of income taxpayers in our country approximately makes up almost 1.4 million. As per report of Economic Survey for Nov.2012 almost 2.6 million of the potential taxpayers are still out of the tax net. This figure speaks itself that how there is only a meager segment of population presently in the tax net while there is a more significant strata among population which is beyond and out of the tax net.

(6) Corrupt Practices

There is every acceptance and rather appreciation among the taxpayers to make use of corrupt practices and take shortcuts to avoid payment of due and fair tax liability. This has lead to rampant corruption in the tax department and machinery.

(7) Constraints of Tax Machinery

The existing cultural realities and social attitudes do warrant for taking a very stringent action against the tax evaders. But writ of financial laws is yet a dream for the tax administration. The divine tax amnesty schemes also provide enough logic to the tax evaders not to be part of the tax net, at high common-man rates. Use of modern technology and inter connected information has yet not taken its pace due to number of constraints.

(8) Advertising

Advertising is a persuasion technique that can greatly support the articulation and development of tax culture. The mass media can further build a strong public opinion for the denouncement of those who happen to evade taxes. Only thus it will be possible to generate a positive interaction between the different social sectors and the tax administration.

In the end let me state that the culture can't be changed only in a year or in a few years period – we have to promote a new tax culture to achieve the object of a prosperous and bright future. This is an evolutionary process which would require number of on-going actions which must be continued with perseverance and commitment. We should launch a mass campaign of tax literacy. The culture of concealments and mis-declarations must be substituted by the emotions of trust, fairness and mutual respect. The machinery of the state should come into play with full force against the tax evaders so that a clear message is conveyed in this regard for appreciation of the taxpayers as well as tax collectors and ultimately our motherland.

DOCUMENTATION OF ECONOMY

By:
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The progress and prosperity of a country mainly depends on documentation of economy.

Inland Revenue Service of Pakistan plays a pivotal role in collection of revenue from direct and indirect taxes to the exchequer of Pakistan. The Government of Pakistan has made all out efforts to enforce documentation of economy in Inland Revenue to boost up revenue collection.

DRASTIC STEPS TO INTRODUCE DOCUMENTATION OF ECONOMY

1. Maintenance of books of accounts was previously mandatory for companies only. In the eve of reforms, the book keeping/maintenance of accounts has been made mandatory for all big and small taxpayers. All taxpayers are supposed to file certificate with return that they have maintained books of accounts. In the eve of selection of case for audit and detailed scrutiny, they have to file accounts. All taxpayers have to maintain invoices, cash memos, cash books, details of receipts and expenditures. Each purchase and sale is to be documented.
2. Companies have to file accounts with return duly audited by Chartered Accountants.
3. Levy of penalty for non-maintenance and non-production of books of accounts is mandatory.
4. The taxpayer’s profile is available in the tax office. Drastic steps have been implemented in the form of assembling data of taxpayers at one place. In Regional Tax Offices and Large Taxpayer Units, one window operation is in

vogue and all information regarding income tax and sales tax is available with concerned officer. The incidence of revenue leakage, concealment and willful non/short payment of tax has been plugged to great extent.

5. The tax department has collected data from other departments and organizations. We have data of taxpayers regarding payment of utility bills, purchase of land, purchase of expensive vehicles from different departments like Excise & Taxation, Wapda, Sui Gas, revenue offices etc. All purchase of land/houses is to be registered. The Revenue Department can obtain all data from Registrar Office and tally with declaration of income of taxpayers. We can thrash out sources of investment and in case all this data is fed in computer in respect of the taxpayers and cross matched with his declaration of income. We have been able to detect various potential cases of concealment of income. This has been made possible by Documentation of Economy. The tax department possesses all sorts of data of taxpayer fed in computers.
6. Since we have been able to gather information of investments, we have discovered a lot of taxpayers and brought them to tax roll but still we have lagging behind in this regime and require extensive efforts to book new cases to boast up revenue collection.
7. With the extensive automation and documentation of economy, now we can verify/match the claim of tax payments (buyer) with sales declaration of sellers. The invoices can be verified. Huge discrepancies of declaration have been detected through audit and loss of revenue has been retrieved.
8. Claim of refund is subject to production of documentary evidence. The genuineness of claim of refund has been made possible through documentation/record.
9. In order to enforce documentation of economy, the government has made it mandatory to affect purchases from taxpayer having sales tax registration number.
10. Every person has to obtain National Tax Number before launching any business concern and disclose complete particulars, address and bank account. This documentation has paved a way to book new cases and carry out fair and judicious assessment. Every supplier and importer has to have national tax

number. Thus, it is every likelihood that no ventures escape tax payments. The incidence of tax evasion and tax avoidance has been minimized. Every transaction is available in black and white.

11. Intelligence and Investigation Wing has been established in FBR which collects all sorts of data of taxpayers from different departments and detects huge cases of concealment and under declaration.
12. In the Income Tax Ordinance, 2001 and Sales Tax Act, 2005, there is mandatory provision of audit. We can audit a certain percentage of taxpayers' returns in a financial year. The books of accounts are examined in detail and all information is cross-matched and fair and judicious assessment is accordingly made. The government has been able to collect huge revenue from audit.
13. The collection of with-holding tax contributes major chunk of collection. All withholding agents are required to file quarterly and annual prescribed statements of tax deduction at source. The defaulters of withholding tax are proceeded, penalty levied and short payment/non-payment of tax is accordingly recovered.
14. The cross matching of declaration of buyer (NTN holder) with declaration of seller (NTN holder) goes a long way in detecting incidence of understatement and short payment of tax in sales tax and FED. No transaction remains untapped. Every registered person has to file sales tax return on monthly basis showing particularly cash transaction which can be verified.
15. Simultaneously, the tax department has started computerized program of budget and expenditure. All expenditure has to be fed into computer. Thus, we have switched from manual record to computerized record of expenditure regimes.
16. In the eve of restructuring of department and reforms, income tax and sales tax have been merged with Inland Revenue. All record of income tax and sales tax has been centralized. With this documentation in tax regime, we can cross match declaration of sales of taxpayers in income tax return with the declaration of sales in sales tax return. In case of discrepancies, we are able to recover short payment of tax.
17. It also serves a deterrent factor for taxpayer who is well aware that no business transaction will remain un-noticed or concealed.

18. Since every withholding agent has to file prescribed withholding tax statements of salary, purchases, payment of rent etc., we have been able to recover less tax revenue due to short/non-payment of tax on purchases.

INFORMAL ECONOMY IN PAKISTAN

Informal economic activity is a dynamic process which includes many aspects for economy and social theory including exchange, regulation and enforcement. Given the complexity of phenomena, the simplest definition of informal economy is "any exchange of goods and services involving economic value in which the act escapes regulation of similar acts". The informal activities take place outside the official or recorded economy in developing countries in particular. It indicates shaken trust between government and economic agents. The underground economy is a clear indication of market distortion, poor governance and disproportionate administrative regularities. Informal economy is economic activity that is neither taxed nor monitored by the government and it is not included in government Gross National Product (GNP) as opposed to a formal economy. In developing countries, where up to 60% of labour force works, all economic systems contain an informal economy.

The terms informal economy, underground economy, black money, parallel economy, shadow economy, under the ground are synonyms.

The informal economy in Pakistan is spreading fast depressing the Gross Domestic Product (GDP) growth resulting in less GDP. Pakistan's black economy is believed to have grown to be more than half the formal economy upsetting government public welfare program.

Black money grows along with corruption, speed money, consultancies, smuggling, narcotics, government contracts and tax evasion, hoarding of essential commodities and includes both untapped legal and illegal activities.

BARRIERS OF ENTRY INTO FORMAL ECONOMY

1. Excessive costs and government regularities as well as corruption in areas like business, start up granting of permits have forced people to remain informal.

2. Disappearance of public sector jobs.
3. Rural to urban migration.
4. Demand for low cost goods and services.
5. Unemployed youth working informally.

Squeezing the informal sector may lead to better collection of Revenue, provision of better public facilities and infrastructure.

The transactions in shadow economy escape taxation thus keeping tax revenue lower. It bears negative effect on economy and revenue collection. When tax base or tax compliance is eroded, the government of Pakistan may respond to raising tax rates and less spending on public sector.

A factory or office worker has a second time job driving an unlicensed taxi at height, a drug dealer broker, a drug with prospective customer but does not declare his earning to tax collector. These are examples of underground or shadow economy activities; in Pakistan, both legal and illegal that add up to millions a year that take place “off the books” out of gaze of taxmen. This is the grey area and reveals failure of government to tap revenue from informal and undocumented sector.

NEGATIVE EFFECTS OF INFORMAL ECONOMY

- To make official statistic unreliable.
- Raising tax rates.
- Worsening of budget constraints or public sector.
- Loss of precious tax revenue for collection.
- Unreported economy due to tax evasion and avoidance.
- Depresses growth of GDP.
- Un-equal distribution of wealth.

HAVE WE ACHIEVED OUR DESIRED RESULTS?

The documentation of economy has played a pivotal role in tax regime in detection of leakage of revenue and plugged incidence of tax evasion and avoidance. Through this documentation, we have gathered more information yet we are lagging behind in revenue collection due to certain handicaps as enumerated below:-

1. Lack of political will to implement policy.
2. Lack of proper training of officers/officials.
3. Non-directional spending of funds from IMF & World Bank.
4. Non-centralization and emergence of functional units.
5. Non-utilization of survey data.

RECOMMENDATIONS

a) Policy has to be implemented by Government in letter and spirit and extension/levy of tax on real estate and agriculture. Political will is required.
b) Broadening of tax base.
c) Proper co-ordination among different functional units of audit, enforcement, IP and legal.
d) Chalking out concentrated training programes of officers/officials.
e) Indiscriminate booking of all new business concerns on tax roll and proper utilization of survey data.
f) To invoke all legal measures to enforce filing of return from habitual non-filers.
g) Incentives for veterans tax payers to enhance honour of compliant taxpayers.
h) Proper Management of Record keeping by the department.
i) To enhance collection from direct taxes also and bring it at par with indirect collection.
j) To bring informal sector of economy in tax net by correct and strict policy.
k) To launch Tax Amnesty Scheme for money laundering and incentive scheme for enforcing filing of returns from new or habitual non-filers.

l) To strengthen tax administration and raising potential for discovery of non-compliant taxpayers.

m) To enhance penalties for tax evasion.

n) To improve attitude of tax collectors.

o) Public awareness for acceptance of tax obligations.

p) Education of masses to promote tax culture.

q) To devise a new social contract between citizen and government that taxes paid by them to be utilized exclusively for the benefit of country.

r) To popularize knowledge of law through education, media for information services.

s) Government to crackdown on underground economy.

t) Universal acceptance of self assessment scheme followed by a very stringent audit backup.

BROADENING OF TAX BASE –A CHALLENGE FOR FBR.

By:
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The Federal Board of Revenue (FBR) has undergone massive reform process during the last few years in the areas of Tax Administration and Policy introducing self-assessment, selective audit, expansion and up-gradation of information technology along with up-gradation of physical infrastructure in order to provide congenial work environment to the tax collector as well as taxpayer. The aim and objective is to simplify tax procedure, optimize revenue collection and maximum facilitation to the taxpayers.

The Tax Administration and Reform Programme (TARP) also embodied a stringent regime of broadening of tax base. The FBR, Pakistan has for the first time in tax year 2011, encouraged investigation of investment in acquisition of costly vehicles and immoveable properties but due to blanket immunity from valuation of properties at market value (existing system of value is based on cost at stamped) significant achievement could not be made. Effective changes are required in statute. Political will is pre-requisite to effect positive changes in taxation of agricultural income and real estate and to plug loopholes in tax evasion.

LOW TAX BASE IN PAKISTAN

It is beyond doubt that we have quite low tax base in Pakistan. Following are two indicators of economy:-

1. **Tax to GDP ratio.**
2. **No. of registered taxpayers**.

It is quite dismal to note that in Pakistan we have narrow tax

to Gross Domestic Product (GDP) ratio of 10.2% which is nearer to under developing countries of third world whereas it is 50% in Denmark, a developed country.

NUMBER OF REGISTERED TAXPAYERS.

Again it is disheartening to note that we have narrow base of taxpayers viz-i-viz total population.

Total population	170 (m)
Registered taxpayers	2.7 (m)
Registered taxpayers salaries class	1.8 (m)
Business and others	0.9 (m)

The source of revenue collection is mostly salaried class and huge tax gap exists in actual revenue collection and revenue receipts. In Pakistan, we have still been able to collect tax from business class and on services from only 0.9 (m) tax payers. This shows huge tax gap which exists at 79% of actual tax receipts.

MASSIVE TAX EVASION/INFORMAL ECONOMY

Informal economy constitutes more than half percent of an economy. It includes all black money underground economy, smuggling, drug business etc. thus depressing over tax to GDP ratio. Although, there are certain hurdles in broadening tax base like distrust of people in use of tax money, negative attitude of tax collectors etc. yet it is dire need to bring informal economy in tax net.

CORE FUNCTIONS

1. **Broadening of tax base** aiming at netting potential taxpayer to tax regime.

2. **Access to major data bases** linkages with all major national, provincial and regional data base.
3. **Cross matching of data with master index and tax profile** for the purpose of non-reporting and under reporting**.**
4. **Complaint handling**
5. **Financial investigation.**

HOW TO BROADEN TAX BASE

1. Tax on agricultural income or income from real estate, agriculture share in GDP is 20% whereas its share in tax is only 1.2%.
2. Political will to implement policy.
3. Co-operation of different government and private agencies in collecting information e.g. NADRA & Banks.
4. To centralize data base system, its linkages with national, provincial and regional data base.
5. To collect, utilize and monitor the data in case of existing taxpayer and also book new taxpayers.
6. To collect information u/s. 176 of the Income Tax Ordinance, 2001 from public and private persons in respect of taxpayers.
7. To cross match information so obtained in case of existing taxpayers, match declaration of assets with those already declared and to detect cases of concealment, under reporting and non-reporting.
8. To book new cases on the basis of such data and allot National Tax Numbers.
9. Collection of information from different organization, like :-

    a) Land revenue authorities.
    b) Motor Registration Authorities.
    c) Suppliers.
    d) NADRA.

e) LESCO and SNGPL.

f) Banks.

g) PTCL and Mobile phone information.

INFORMATION TO BE COLLECTION U/S. 176

1. Data of motor vehicles.
2. Purchases of house/plot.
3. PLS accounts of taxpayers.
4. Utility bills of electricity, gas, mobile phone, etc.
5. Value of import, export and supplies.

10. To enforce just and equitable system of assessment.
11. To formally document the economy.
12. Acceptance of self declaration from income followed by strict audit back up.
13. Filing of wealth statements in cases of income exceeding Rs.5, 00,000 and examine accretion of assets.
14. Withdrawal of sector exemptions in investment rebates and allowances. The exemptions pave the way to misuse of law, unequal statement and whitening of money.
15. To introduce tax amnesty scheme to pay tax in installments to avoid litigation.
16. Automation progress is fairly good on sales tax side as tax data base is being maintained properly. It needs to be expedited on income tax side. So far the partial shift to e-filing has been made but sufficient data base has not yet been made for meaningful desk audit.
17. Effective enforcement of sales tax laws to check un-authorized collection of sales tax. The departmental capacity to desk audit the sales tax return within reasonable time is lacking provoking manipulation with sales tax.

18. Broadening of sales tax base in cases where turn over exceeds basic threshold calling for compulsory registration.

In nutshell, reform process has been completed with the finalization of TARP in December, 2011. Despite launching of such an extensive reform packages, various problems still continue which include narrow audit base, limited desk audit capacity, excessive jurisdictional changes, un-smooth excess to records. It is high time to evaluate reforms and to take suitable measures to make them complete success.

CAN PAKISTAN GET OUT OF LOW TAX-TO-GDP RATIO TRAP?

By:
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Today, Pakistan has the lower Tax-to-GDP ratio (i.e. 10-11%) compared to other Asian countries like Sri Lanka 13%, India 16%, Indonesia 15%, Malaysia 14%, Thailand 17% and South Korea 16%. This weakness has put Pakistan in deep quagmire of debt trap. This trap, by nature, is intriguing, cyclical and suffocative.

The trap starting with a stagnant tax-to-GDP ratio, entails cuts in public development expenditure, hampered growth momentum, squeezed tax potential, forced public borrowing, unemployment, poverty, burgeoning inflation, suppressed aggregate Demand & Supply. The results are poor basic economic infrastructure, critical shortages, flight of capital, poverty, law & order, social disorientation, corruption and institutional failure. A stark example of this is the increase in power outages which has cost the economy billions of rupees. On top of this, the falling share of divisible pool taxes in the GDP has implied lower growth in intergovernmental transfers to the provincial governments leading to a loss of dynamism in social sector expenditures.

Tax collection and GDP have mathematical correlation. Pakistan has almost stagnant trend of overall and individual tax- to-GDP ratio during the last two decades. Simultaneously, there have been major changes in the taxation structure. The importance of customs and excise duties has declined in the face of World Trade Organization (WTO) initiatives & standards, while that of income and sales tax has increased.

Since the early 90s, Pakistan has been engaged in a process of economic liberalization as the emphasis in development strategy shifted from import substitution to export promotion. Consequently, import tariffs have been scaled down gradually from initially very high levels to a maximum tariff of 25% currently, with a number of slabs reflecting cascading of the tariff structure. The average effective rate of duty on imports was 30% in 1990-91 which has fallen below 6% by today. The implication of the tariff reforms is a major decline in the tax-to-GDP ratio of import duty from almost 5% to just over 1% of the GDP over the last 20 years. This was bound to exert a strong downward pressure on the overall tax-to-GDP ratio unless complimentary reforms were undertaken to raise the tax-to-GDP ratio of other taxes.

Major reforms have in fact been undertaken in direct taxes. During the early to mid-90s an elaborate withholding/presumptive tax regime was put in place. Beyond the typical deductions at source of wage income, unearned capital income was brought into the tax net. Deductions at source were introduced on income from bank deposits, securities, national saving schemes, dividends, house rentals etc. In addition, withholding taxes in the form of advance taxes were introduced on proxies of income like electricity, telephone and gas bills, cash withdrawals from banks, car sales etc. Today as many as 11 sections of Income Tax Ordinance, 2001 relate to withholding taxes. The regime of withholding/ presumptive taxes has not only simplified the tax system and eliminated the discretion of tax officials it has also contributed significantly to higher revenues. The direct tax-to-GDP ratio has increased by over 2% of the GDP. Although, some of the impositions like the presumptive taxes on importers and contractors have been considered as regressive in character, there is no doubt that deductions at source from capital income have contributed to a more progressive tax system by reducing the extent of tax evasion.

The other area of reforms is in the sales tax. Sales Tax act of 1990 embodied elements of VAT. The tax base was broadened initially to cover more goods like petroleum products, electricity and gas. Subsequently, a number of large and rapidly growing services like telecom were brought into the tax net. The standard tax rate has also been enhanced from 12.5% to 16%. The result is that over the last 2 decades the sales tax to GDP ratio has increased by 2%age points.

Surcharge on petroleum products and natural gas has been a variable source of revenue. In the case of the former they have acted as a cushion between domestic and international prices. Therefore, when the global oil prices have risen, the yield from the surcharge has been less. In good years with relatively low import prices of POL products, the overall revenue from surcharge has approached 1% of the GDP. In an effort to reduce variability, the government has introduced the concept of the Carbon Tax. Fixed specific tax per liter has been levied on each petroleum product.

Overall, it is clear from the above description that loss of revenue from the process of trade liberalization involving reduction in import tariffs has only been partly compensated for by reforms in direct and sales tax. This raises the fundamental question about the sequencing and pace of tax reforms in the country. It also raises the question of partial success of tax reform in Pakistan.

While the above examples illustrate success in the reform efforts, there have also been some failures. From 1998-99 onwards, under the ESAF program, emphasis was placed on development of agriculture income tax to extend the base to agriculture sector and thereby reduce horizontal inequality. It was expected the move will yield revenue of about 0.3% of GDP, equivalent to Rs.40 Billion at current GDP. Legislation was drafted accordingly. However, the tax was imposed in a half-hearted manner which now yields revenue of about RS. 1.5 billion only. The tax reform has been a victim of lack of political will to tax the big land owners in the country.

Another such reform was introduced under the IMF standby facility in 2000-01 which involved efforts at extending the GST to retailers. Even a tax survey was undertaken but the exercise was abandoned due to street protests by the traders. Effective broadening of the tax base was also rendered difficult by the absence of adequate documentation in the economy. In another effort, **Poverty Reduction & Growth Facility** Programme for 2001-02 to 2003-04, the tax-to-GDP ratio was to be raised from 10.5% to 14.3%, but the actual ratio dropped down to 10.3%.

Experts say that political will and governance capacity play a key role in the success and failure of any tax reform. Further, tax concessions, exemptions and zero-ratings have been a common norm of our various governments all along, which has checked the growth of tax-to-GDP ratio performance of the country.

FBR's track record viz-a-viz improving tax-to-GDP ratio can be viewed through 'base' and 'rate' effects. The former essentially identifies to what extent the change in tax-to-GDP ratio is due to change in the ratio of the tax base to the GDP. That is, if the tax base of a tax is stagnant/buoyant in relation to the GDP then the 'base' effect will be negative/positive, implying other things being equal, a fall/rise in the tax-to-GDP ratio.

The rate effect is meant to primarily capture the change in the effective tax rate on the tax base. Effective rates can change if statutory tax rates are altered or, if given unchanged statutory rates, there is an increase in exemptions or a change in the efficiency of tax collection.

The striking conclusion is that during the last two decades the overall rate effect has been negative while the base effect has been positive. It appears that the tax-to-GDP ratio of Pakistan has not been held back by slow growth of tax base but more by a policy of reduction in statutory tax rates and by exemptions on existing tax base.

The decade of 90s witnessed a substantial scaling down in import tariffs which was only responsible for a fall of over 4%age points in the tax-to-GDP ratio. The contribution of direct tax reforms has been substantial in terms of contributing to a positive rate effect of almost 2% of GDP. The sharp contrast between the large negative weight effect and positive base effect is vividly illustrated in the last decade.

This was a period of relatively fast growth and the primary tax base of the economy i.e. manufacturing, banking, insurance, transport, communications and imports showed extraordinarily rapid growth. This should have led to an increase in the tax-to-GDP ratio but it did not happen due to the policy of bringing down statutory tax rates and granting of more exemptions. From 2001-02 to 2007-08, as more fiscal space was created by larger aid inflows and debt rescheduling, there appears a visible slackening of the fiscal effort and resort to the supply side economics of stimulating growth, by tax cuts. The first step was abolition of the wealth tax.

This was followed by sharp reductions in tax rates. The corporate tax rate was brought down from 40% to 35% and for banks from 58% to 35%. The maximum personal income tax rate for salary earners was reduced from 35 to 20% and for the self-employed to 25%. Some withholding tax rates were also scaled down. Simultaneously, a number of significant exemptions were also granted. The entire domestic sales of 6 export oriented sectors including textile were Zero rated from sales tax. Agriculture inputs and machinery were also given GST exemption. Excise duties were withdrawn.

The jump in private investment was not reflected in higher revenues due to the presence of accelerated depreciation allowances and tax holidays. The boom in the stock market and the enormous capital gains were not translated into revenues due to the continued exemption of the capital gain tax on shares. The slackening in the quality of tax administration is indicated by the lack of growth in the number of tax payers, which remains at about two million. The introduction of Self-Assessment Scheme was not accompanied by a strong audit process. Collection from demand following audit has remained poor.

Tax collection capacity of provincial governments reflects a similar situation. Their combined tax-to-GDP ratio has languished below 0.5% of the GDP. Given the overwhelming dependence on transfers from the Federal Government, they have had little or no incentive to develop their own tax system. During the last decade there has been an explosion in property values but it did not yield a rapid growth in provincial revenues from stamp duty and property tax.

Overall, during the last decade a historic opportunity for achieving a significant leap in tax revenue during the period of fast economic growth was lost. The above analysis shows that if somehow the negative rate effects could have been avoided, Pakistan's tax-to-GDP ratio would have been closer to 13% of the GDP, 2.5%age points higher than the present one.

Pakistan falls in the category of countries with low taxable capacity and moderate tax effort. With no negative rate effects, Pakistan could have achieved a success. Under pressure of vested interests, Pakistan has developed a culture of tax exemptions and concessions, which are actually tax expenditures. Exemption of buoyant capital gains, stocks, property values, from tax, has ridiculed the whole idea of tax reformation. The said exemptions, concessions, credits and zero-ratings are genuinely tax expenditures accounting for a loss of 3% of whole economy. Thus, withdrawal of such expenditures would alone give a big strike to break the trap.

Deep in this trap, the way out is an effective Resource Mobilization Strategy (RMS). Such RMS should be based on serious consideration of hitherto two phenomenal fiscal wrongs:

i) Inflationary pressures (taxing the taxed)
ii) Horizontal inequalities (untaxed sectors)

The RMS should be premised on the following 3 pillars:

i. Transforming GST into real VAT
ii. Improving Direct Tax Administration (DTA)
iii. Enhancing Provincial Tax-to-GDP ratio

With one step of replacing GST with VAT, two big wrongs can be corrected. VAT has not missed the attention even of countries like Sri Lanka and Bangladesh. VAT is operating in over 130 countries of the world. It will achieve big milestones of covering all sectors, so far enjoying concessions, exemptions, zero-ratings and non-taxability like services. It will broaden the base manifold. For improvement of direct tax administration, conversion of presumptive to a minimum tax and taxing capital gains, portfolio shares and properties, be undertaken without further loss of time.

Today, 4 provinces combined generate less than 0.5% of national GDP as their revenue. 7th NFC with 57% transfers to provinces has further slackened their urge and effort to exploit and explore their own avenues of revenue. Currently they hold jurisdiction over Agriculture Income Tax (AIT), property tax and GST on services. A presumptive tax on landholdings and crops at marketing stage should be levied.

With the Compliments of

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Federal Board of Revenue
Government of Pakistan

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