

Finding of the FBR's High Powered Commission
Pursuant to order of the Honourable Lahore High Court in
W.P. No. 19084/2013 JDW Sugar Mills

This High Powered Commission was constituted by Chairman Federal Board of Revenue, Islamabad, vide Board's order number: F.No.(3)SS-TPA/2013/ 58901 dated:17-04-2012 read with order of even number dated: 15-05-2014 pursuant to directions of the Honourable Court contained in judgment/order passed in WP 19084/2013 JDW Sugar Mills Ltd VS Federation of Pakistan etc (LHC). The Commission has duly deliberated and has revisited the whole issue as directed by the Honourable Lahore High Court.

Audit of Tax Affairs- An Overview

2. Power to collect taxes is an essential and inherent right of a sovereign state and it enables the state to generate financial resources necessary for perpetuation of its sovereignty, maintenance of law & order and attainment of ultimate objective of becoming a progressive and developed welfare state. Under article 5 of the constitution of the Islamic Republic of Pakistan, every citizen is duty bound to show subservience to all the laws including taxation laws.
3. Concept of "audit" is best explained by the relationship between the state, citizens and taxes. Tax on income is the share of the state in income earned by its subjects in lieu of its responsibility towards citizens, to the extent of rates/percentages fixed through statutes approved by the Parliament. Therefore, the state has a right to ascertain if its due share is being paid. The privilege to determine and pay the tax voluntarily has been extended to the taxpayer under the Self-Assessment Scheme and, therefore, it is imperative that the taxpayer maintain prescribed books/records to facilitate fair and judicious audit if the state decides to follow that course for verification of the declared versions.
4. Thus there are two conditionalities, firstly the declaration and self assessment of income by the "taxpayer" and secondly an audit of such income declarations in some cases by the state authorities. While the former i.e. self-assessment by the "taxpayer" has gained wide acceptance by the taxpayers, the latter principle i.e. "audit" by the state is mostly avoided, resisted and even those who accept it do so reluctantly. Consequentially the tax machinery has been stalled from conducting audit in a smooth manner. Under the Scheme of Income Tax Ordinance 2001, trust has been reposed in the taxpayer by extending facility of Self Assessment whereby a return filed by the taxpayer under Section 114 of the Income Tax Ordinance, 2001 constitutes an assessment within the contemplation of Section 120 of the said Ordinance. This is a significant change from the taxation mechanism prior to 2001 whereby the emphasis has been on reposing trust in the taxpayers.
5. The superior judiciary has also endorsed the above mentioned view and explained the concept and vital importance of audit in the scheme of Income Tax Ordinance, 2001 in the case reported as 2007PTD239 (the Honourable Lahore High Court, Lahore), as under:-

"9. Conduct of audit into the income tax affairs (including examination of account and record, enquiry into expenditure, assets and liabilities), is new concept introduced for the

first time in income tax laws in Pakistan. It has to be understood in the scheme of Ordinance, 2001. The power to select a case for audit was power vested with the commissioner, who in relation to income tax affairs of person, having regard to clauses (a) to (d) of section 177(4) of Ordinance 2001, could select a case for audit. Section 177 was substituted through Finance Act 2004 and Sub-Section (1) was added, in view whereof Central Board Of Revenue was also given the authority, in its supervisory capacity, to lay down a criteria for selecting any person for audit through the Commissioner and the Commissioner, on the basis of that criteria, is to select a person for audit, besides the powers vesting in him under Sub Section 4 of Section 177.

“10. an assessee, under repealed Ordinance, 1979, was to file return of total income U/s 55. The Assessing Officer had the power, under Section 59A, to accept the return after satisfying himself that return of income was correct. In case the Assessing Officer was not satisfied, a notice/action U/Sections 61 and 62 was the consequence whereby an assessee was asked to produce evidence in support of the declarations made in the return. The Assessing Officer in pursuance of action in terms of Sections 61&62 was required to specify the defects and confront the assessee with it. The Assessing Officer was to proceed in the matter as quasi judicial authority and in that capacity was to receive evidence from the assessee. If the evidence produced by the assessee was found defective / inadmissible the Assessing Officer was required U/s 62 to pass an assessment order wherein the declared income /result was rejected and the income of assessee was computed in accordance with law through a speaking order. Law had provided the remedy of appeal against the assessment order before Commissioner Appeals and 2nd appeal before Income Tax Appellate Tribunal. Besides the remedy of Appeal against the assessment order, the assessment could be reopened either U/s 65 (on definite information regarding concealment or inaccurate furnishing of particulars which resulted into escaped assessment or assessment at too low rate or under assessment or excessive relief) or u/s 66A (where the Inspecting Additional Commissioner could revise order by canceling, amending or evaluating or modifying the assessment or directing fresh assessment), where order passed was erroneous and prejudicial to the interest of Revenue.”

“11. in departure from the above explained assessment under the normal provision of the Ordinance of 1979, the self-assessment scheme, U/s 59, was also formulated / issued by CBR, which normally used to be conditional and only the person whose return qualified under the scheme could claim acceptance of his declared version. The declared version was subject to preliminary/brief scrutiny, as provided under the scheme and U/s 59 (1). Where after, either order U/s 59(1) was passed or deemed order used to take place U/s 59(4). The rationale behind the scheme was to facilitate those assesseees who had clean record, were not involved in litigation and were gradually increasing their income. Some %age of the qualified return used to be selected for assessment (U/s 62 or 63) as authorized U/s 59(1A). CBR was to announce scheme of self assessment for each year”

“12. Return under the new Ordinance (Ordinance XLIX of 2001) is furnished U/s 114, which on furnishing the complete return, constitutes an assessment within the contemplation of section 120. In the event of filing an incomplete return, the taxpayer is

asked by the Taxation Officer, to makeup such deficiency within stipulated period (not beyond one month). The return again constitutes an assessment order on making up the deficiency. The assessee in the earlier enactment could revise his/its return only prior to the completion of assessment, but under the new Ordinance it can be revised even after the completion of assessment and as many times as the taxpayer considers appropriate. The taxpayer in this respect has to meet the condition that an error or omission was found in earlier return. The concept of audit, subsequent to completion of assessment, has been introduced, in the new enactment, to keep a check on the veracity of the declaration made in the return."

"13. the new law is enacted with the main difference that previously the Assessing Officer used to examine return of assessee and satisfy himself so as to its correction before passing an assessment order. The Income Tax Ordinance, 2001, is to "let the taxpayer make his/its own assessment". Now the assessment order is made by operation of law on furnishing of the complete return. The Government/Revenue reserves its right, against the above concession, to look into the affairs of the income of the taxpayer by resorting to the newly introduced concept of audit. The exercise of seeing the correctness of return is undertaken by selecting a person for audit U/s 177. The selection of cases for audit is to keep check on taxpayer for filing true and correct returns. Section 177 comprises of two parts, each conferring upon the Commissioner i.e. authority to select a person for audit. The commissioner selects a person for audit either on the basis of criteria laid down by FBR or by resorting to Sub-Clause (4) of Section 177. While resorting to the latter course, regard to clauses (a) to (d) is an essential requirement. The impugned notices selecting the petitioners for audit fall under the latter category i.e. U/s 177(4). The authority of Commissioner to select a person for audit, U/s 177 is twofold, firstly on the guidelines of FBR as envisaged in sub-sections (1) and (2) and secondly at his own by resorting to provisions of sub-section (4). The Commissioner for the purpose of selecting for audit has to resort to the criteria laid down by FBR in the cases falling under first category. Disclosure of reason that the regard having been given to clauses (a) to (d) of sub-section (4), is requirement for the cases falling under second category. The affairs of income of the petitioner fall in the second category, therefore, at the time of selection for audit, only the disclosure of reason was the requirement of law"

6. Under the Income Tax Ordinance, 2001, an assessment order comes into existence by operation of law simply by the act of furnishing of a complete and true return of income. Thereafter the State/Revenue has the right, (In exchange for this concession of self assessment) to check the veracity of self assessed income and tax payable on such income by applying the provisions of Sections 177 and 214C of the Income Tax Ordinance 2001, which envisage audit as under:-

- (i) The Commissioner, the focal authority around whom the whole scheme of new Ordinance revolves, has inherent/original power to call for record of any person for the purpose of conducting its audit;

- (ii) Through section 214(C) the legislature has also empowered the Board to select persons or classes of persons for audit through computer ballot which may be random or parametric;
- (iii) While inserting section 214C the legislature, being mindful of the fact that original power of the Commissioner to call for record of any person for conducting audit is distinct and not compromised by insertion of this section, kept his original power distinct and separate by consciously inserting another proviso 177 and creating an exception in sub section (2) of section 214C through the expression as:

“Procedure given in section 177 and all the provisions of the Ordinance, except the first proviso to sub-section (1) of section 177, shall apply accordingly”

7. Some taxpayers whose cases were selected for audit through random computer ballot or whose cases were taken up for audit by the Commissioners of Inland revenue have been resisting audit and have been invoking writ jurisdictions of Honourable Superior Courts. Superior judiciary has however not endorsed such attempts and reliance in this regard is placed on the landmark judgment of the Honorable Supreme Court of Pakistan reported as 2009-100 Tax 81(SC), in the case of M/s Eli Lilly Pakistan (PV) Ltd. etc wherein the apex court in Para 54th has held that:-

“It appears that the respondents (taxpayers) have been trying to take advantage of the technicalities, but we are afraid, they must fail. If their cases do not fall within the ambit of provisions of section 122 on account of the same being prospective, they cannot exclude their assessments from the purview of section 65 of the repealed Ordinance merely because of the lapse of the draftsman who omitted sub-section (1) of Section 239 at the amendment stage. Had the provisions of sub-section (1) of section 239 of the Ordinance continued on the statute book, there would have been no ambiguity and no difficulty at all. In that eventuality, the assessment upto the period ending on 30th June, 2002 would be governed by the relevant provisions of the Repealed Ordinance as if the Ordinance had not come in force.”

The apex Court in Para 57th of the aforesaid judgment has further held that:-

“As already noted, section 65 of the Repealed Ordinance provided a period of five years for an additional assessment and such assessment was to be dealt with under the said provision in accordance with original section 239(1) of the Ordinance. The learned High Courts failed to take into consideration this aspect of the matter and did not direct that the assessments completed under the Repealed Ordinance would be subject to the provisions of the said Ordinance, as originally provided in the Ordinance at the amendment stage. We fill this lacuna in the impugned judgments and direct that the assessment of any year ending on or before 30th 2002 would be governed by the Repealed Ordinance and shall be dealt with as if the Ordinance had not come into force”

8. The above cited findings of the Honourable Supreme Court of Pakistan lead to the obvious conclusion that the taxpayer cannot absolve himself/itself of his/its legal and constitutional obligations to offer its accounts for verification into their correctness or otherwise by the tax authorities.

9. Nonetheless divergent decisions of various honourable superior courts on audit issue were received and some of those judgments reported hereunder:

- In first round of litigation the selection of cases for audit for the tax year 2003 were challenged before the Honourable Lahore High Court, the honorable court declared the selection illegal/void vide its judgment reported as 90 Tax 81 titled as Ch. M. Hussain Vs CIT Sialkot. This judgment was assailed by the Revenue before the Honourable Supreme Court and the Apex Court vide judgment reported as 94Tax317 titled as CIT Vs Fatima Sharif Textile, Kasur expunged/deleted para 8 and last portion of para 12 of the judgment of the honourable High Court and remanded the matter for issuance of fresh notices to the taxpayers in terms of section 177 disclosing reasons for selection of their cases for the purpose of audit.
- The issue of audit also came up before the honourable Supreme Court in the case of Pakistan Mobile Communication Ltd wherein a Division Bench of Honourable Islamabad High Court in W.P. No.517 of 2009 declared selection of case for audit in accordance with law. The Apex Court vide order dated 11-09-2009 in taxpayer's C.P No.1664-1665 of 2009 disposed of the petition with the observations that the petitioner taxpayer shall file reply to the show cause notice before the commissioner raising all legal objections available to him and the legal objections shall be disposed of preferably before proceeding on merit and thereafter if need be merits of the case shall also be considered. Some judgments of Honourable High Courts endorsing indispensability of audit are cited hereunder:
- 2007 PTD 239 HC Lhr. Syed Bhais (Pvt) Ltd. Vs FBR. The Honorable Court in this judgment dilated upon the concept of the audit in length and held that no prejudice is caused to the taxpayer on being selected for audit for confirmation of veracity of declaration made by the taxpayer in its return u/s 114(2)(b) of the Income Tax Ordinance, 2001, if the true particulars have been made in return of income and record is maintained as per law.
- (2009)99 Tax 239 (HC Kar). Nobel (Pvt). Vs FBR. The Honorable Court held that there is no provision in Income Tax Ordinance, 2001 which bars selection of case for audit u/s 177 ibid, if for that same tax year action has already been taken u/s 122 ibid. It was also held that before promulgation of sub-section (1A) of section 120 of the Income Tax Ordinance 2001, Commissioner had power to select cases which fall under provision of sub-section (1) of section 120 ibid for audit and sub-section (A1) of section 120 of the Income Tax Ordinance 2001 has retrospective effect.
- 2010PTD 395. Roots Montessori and High School Vs CIT. The honorable Court held that audit was not a conclusion of any proceedings, but was only a beginning thereof.

- 2011 PTD 2708. E.M. Oil Mills & Industries Ltd. The Honorable Court held that the Commissioner could select any case for audit after recording reasons in writing if upon examination of a statement of accounts he came to conclusion that the same did not depict true state of affairs.
- WP No.960 of 2008 Petroleum Exploration Ltd. Vs CIT. The Honorable Court held that non-issuance of show cause notice for calling of books of accounts for the purpose of audit u/s 177 does not amount to violation of principle of natural justice when selection of a case or calling of record for the purpose of audit is a very preliminary stage where taxpayer can satisfy the revenue that the income shown in the return truly depicts the income accrued to him and the expenditures shown by him have really been incurred and before any action the taxpayer also gets at least two opportunities one u/s 177(6) i.e. opportunity to raise all issues in audit and then before any amendment again proper opportunity of being heard is also provided u/s 122(9) of the Ordinance.
- 2009 PTD 1507. Mohsin Raza Vs FBR. The Honorable Court held that the Commissioner could not select a case for audit unless criteria provided have been dully fulfilled. Selection of cases by the Commissioner was declared illegal/void.
- W.P. No.11166/2009. M/s. Saddar Anjuman-e-Ahmadia etc. In this case the issue of audit along with earlier judgments of the Apex Court was discussed in detail and decided in favor of revenue.
- 2011 PTD 1558 titled as Shahnawaz (Pvt) Ltd. Vs FBR, (Sind High Court). The provisions of section 177 of the Income Tax Ordinance 2001 also underwent a change through Finance Act, 2010 and section 214C of the Income Tax Ordinance 2001 was also introduced. After this amendment calling of books of accounts for audit by the commissioner and selection of cases by the Board for audit was again challenged before various Courts. The selection of cases for audit by the Board for tax year 2008 was declared illegal by the Sindh High Court vide judgment reported as 2011 PTD 1558 titled as Shahnawaz (Pvt) Ltd. Vs FBR, observing that section 214C would affect vested rights hence cannot be applied retrospectively.
- WP No. 16022/2011 titled as Naeem Ahmed Vs FBR dated 19.12.2001 (LHC, Multan). The Multan Bench of the honourable Lahore High Court vide judgment dated 19.12.2001 in WP No. 16022/2011 titled as Naeem Ahmed Vs FBR has declared the calling of books of accounts for audit by the Commissioner within the four corners of law observing that if the petitioner has complied with the provisions of law by filing the return correctly he is not going to be adversely affected by production of relevant record.
- JDW Sugar Mills Ltd VS Federation of Pakistan etc, W.P.No.19084/2013.

Recently, the honourable LHC took up the audit issue for the TY-2011 and passed a Consolidated Order wherein the honourable court, giving effect to this “High Powered Commission” held that:-

“This consolidated order shall decide the instant petition, as well as, petitions mentioned in Schedule A to this order as common questions of law and facts arise in these cases.

2. *After arguing the matter at some length, a solution has been proposed by the Member (Taxpayers Audit) FBR through the present impasse;*
 - (i) *That if the instant petition, as well as petitions mentioned in Schedule A to this order are dispatched to the Federal Board of Revenue, the Chairman, FBR will constitute a high powered “Audit Commission”, which will look into the grievances raised by the petitioners and try to resolve them at the earliest;*
 - (ii) *That the Audit commission while resolving the issues raised by the petitioners will disregard the position taken by the FBR in these cases in their comments filed before this Court and will address the questions raised with a fresh mind and try to resolve them at a policy level, keeping in view the overall scheme of the Income Tax Ordinance, 2001.*
 - (iii) *That till such time the matter is finally resolved through a speaking order / policy statement by the Audit Commission, no adverse action shall be initiated against the petitioners in pursuance to the notices impugned in the instant petition as well as, petitions mentioned in Schedule –A to this order.*
 - (iv) *That Chairman, FBR will also include a nominee of the Federation of Pakistan, Chamber of Commerce & Industry (“FPCCI”) in the Audit Commission.*
3. *Learned counsel for the petitioners are in agreement with the above arrangement and have no objection if the instant petition, as well as, petitions mentioned in Schedule-A to this order are disposed of in the above terms”.*
- C.M.A. NO.2993 OF 2014 IN C.A. NO.860 OF 2014 M/s. Riaz Bottles (Pvt) Ltd. Very recently, endorsing the vitality of existing appellate authorities and discouraging the trend to bypass those authorities, the Honourable Supreme Court of Pakistan has held that:-

“We have heard and considered the arguments of the learned ASC. Granted that the case of the appellant has been selected for audit but no material on the record has been highlighted by the learned ASC showing that the case of the appellant under the three laws was selected for audit by one ballot. Even otherwise, it would not be in the fitness of things to restrain the respondents from proceeding further notwithstanding the grant of leave. Firstly because the final order is yet to be passed, secondly because such order is amenable to appeal and thirdly because the amount deposited pursuant to the determination of liability shall be refunded if the appeal before this Court is decided in favor of the appellant. For the reasons discussed above. CMA No.2993 of 2014 being misconceived is dismissed”.

Hence the issue of audit by application of the provisions of sections 214C and 177 of the Income Tax Ordinance 2001, even having caught sight of the Apex Court more than once is yet to be settled conclusively.

10. For the Tax Year 2011 FBR adopted computer ballot based on parametric selection of cases for tax audit U/s 214C of the Income Tax Ordinance 2001. This was contested in a writ petition before the honourable LHC, Multan bench which in the I.C.A No. 116/2013 titled M/s Ittefaq Rice Mills Vs Federation of Pakistan decided as under:

“11. Perusal of the minutes of the Meeting of the FBR’s Board-in-Council dated 15-2-2013 reveals that the FBR has honoured the commitments recorded in the above cited judgment of this court”

“23. for the above reasons, we find no illegality or error in the selection for audit of the appellant for the Tax Year, 2011 through letter dated 20-03-2013 issued by Respondent no.3. For the same reasons, the order of the learned Judge in chambers does not call for any interference. This appeal is, therefore, dismissed with no order as to costs”

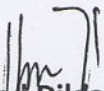
However subsequently a large number of Writ petitions were again filed by various taxpayers challenging their selection for audit through computer ballot based upon parametric selection. Notwithstanding the fact that the petitioners had also availed the opportunity of representation before the review panels and the panels had observed that the selection of those cases was in order and did not call for any interference. In the case titled JDW Sugar Mills W.P No. 19084 of 2013 the honourable LHC passed a Consolidated Order directing Chairman FBR to constitute a “High Powered Commission” to review and dispose of the cases of the instant petitioners i.e. Schedule-A to that Order.

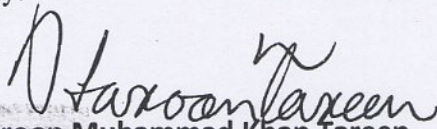
11. Therefore, the “High Powered Commission” in its meetings/deliberations on 09-09-2014 has reviewed threadbare all the cases, referred to in the aforesaid order of the honourable Lahore High Court, and in compliance with the directions of the Honourable Lahore High Court, the Commission has not discussed or taken into consideration the earlier stance of FBR before the Honourable Lahore High Court in the W.P 19084/13 and the cases of all the petitioners have been considered with a fresh mind. These deliberations have resulted in the following conclusions:


- i. Selection of all the aforesaid cases for audit for tax year 2011 was IT based and were conducted in a transparent manner.
- ii. Selection of all the aforesaid cases for audit for tax year 2011 was judicious and non-discriminatory and thus in line with the directions of the Honourable Lahore High Court in W.P No. 30786/2012 (*M/s Premier Industrial Chemical Manufacturing Co*).
- iii. The Commission noted that out of total cases numbering 12,609 selected for audit for tax year 2011, in 2,169 cases audit has already been completed resulting in demand of Rs.1,893 million and recoveries have also been made out of the said demand. On the other hand the taxpayers aggrieved of audit are only 38 in number out of the said 12,609. Any departure from the policy at this stage would not only adversely affect the entire process but would have an adverse impact on cases already audited in as much as that any deviation from the laid down policy can again be viewed as discriminatory in respect of such taxpayers.

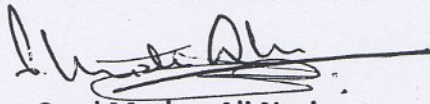
- iv. There is adequate remedy by way of appeal, available to a taxpayer aggrieved of any amendment of his assessment (pursuant to an audit).
- v. Besides appeal the petitioners have a right of representation against any maladministration by FBR officials, before Chairman, FBR u/s 7 of FBR Act, 2007.
- vi. Audit will be transparent and IT based. All notices/orders etc in the cases of these petitioners will be issued through Tax Audit Management System (TAMS) and will be monitored by FBR.

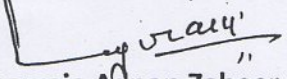
12. The Commission, therefore, finds that in order to maintain uniformity and ensure non-discrimination amongst taxpayers who were selected for audit for tax year 2011, the audit policy should apply equally to all such cases including those specified in the Schedule-A to the Judgment in W.P 19084/13 and all cases be audited accordingly.



Mr. Ahmed Dildar
 Member (Legal)/
 Chairman (Audit Commission)



Mr. Haroon Muhammad Khan Tareen
 Member (Taxpayers' Audit)/
 Member (Audit Commission)

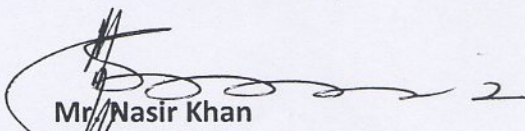

Mr. Aftab Ahmed
 Chief Commissioner Inland Revenue,
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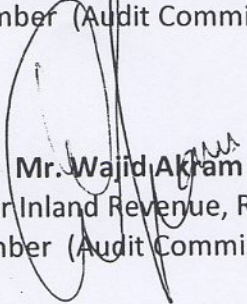

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