

**GOVERNMENT OF PAKISTAN
REVENUE DIVISION
FEDERAL BOARD OF REVENUE**



**TAXPAYERS' AUDIT WING
AUDIT POLICY 2015**

MISSION STATEMENT

- **Develop fair and effective tax administration.**
- **Enforce compliance of Tax Laws.**
- **Ensure efficient and high quality professional results.**
- **Promote taxpayer facilitation and education.**

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Foreword

The taxpayer audit function plays a critical role in the administration of tax laws. One of the primary goals of the Federal Board of Revenue (FBR) is to improve the overall compliance with the tax laws and in the process instill confidence in the community that the tax system and administration are fair. Historically most compliance risks have been addressed, nearly exclusively, in terms of regulatory enforcement through an audit based approach.

The FBR has realized, in recent times, that the factors underlying taxpayers compliance behavior in any risk area are varied and often complex and are unlikely to be treated successfully with a “single action” strategy, particularly one based exclusively on regulatory enforcement actions such as audits. Therefore, the FBR, now follows a combination of Taxpayers facilitation and compliance strategies. It essentially means encouraging the taxpayers to comply with the tax laws voluntarily through self assessment and at the same time mitigate the risk of false declarations by employing a fair, transparent and non-discriminatory Audit Policy. Moreover, the interface between the Taxpayer and the Tax Collector has substantially been reduced through extensive use of information technology, automated business processes and legislative interventions aimed at improving and impersonalizing the tax compliance system.

The overriding consideration for conducting taxpayers’ audit stems from the need to check compliance to tax laws and to verify the accuracy of declarations made by them. Given the fact that the level of documentation of economy leaves a lot to be desired and recognizing the existence of trust deficit between the tax collectors and the taxpayers as well as the unresolved

legal disputes, the FBR, through this policy, endeavors to clear the air, remove the bottle necks and settle disputes through an institutionalized mechanism.

In the wake of the ratio decidendi of judicial pronouncements on the issue of selection of cases for audit, this policy document has, to the extent possible, embraced principles and guidelines that ensure a transparent and judicious system of audits. The existing legal mechanism for selection of cases of persons for audit is based on random or parametric computer ballots by the Board. The Commissioners are also empowered to select cases for audit under the relevant statutes. Within the aforementioned methods of selection, the present policy envisages selection of persons for audit through a fair and transparent process, based on risk analysis and bench marking studies.

In the present day context, it is neither advisable nor feasible to audit every single taxpayer. Taxpayer's population to be audited is therefore to be determined keeping in view the capacity of the workforce available with the field formations. FBR, therefore, has developed an effective compliance management system through promoting voluntary compliance achieved through self assessment, and developing modern approaches to audits based on effective risk management.

ABBREVIATIONS

- i. **FBR:** Federal Board of Revenue
- ii. **LTU:** Large Taxpayers' Unit
- iii. **RTO:** Regional Tax Office
- iv. **CIR:** Commissioner Inland Revenue
- v. **TAMS:** Tax Audit Monitoring System
- vi. **IT System:** Information Technology System

Part 1

AIMS AND OBJECTIVES

Following are the aims and objectives of the Audit Policy 2015:-

- 1.1** To promote voluntary compliance of the taxpayers with the tax laws. It seeks to achieve this by reminding taxpayers of the risks of non-compliance and by engendering a degree of certainty in the broader community that serious abuses of the tax law will be detected and appropriately penalized.
- 1.2** To make the process of selection non-discriminatory and transparent by selection of cases of persons or class of persons for audit through computer ballots.
- 1.3** To create an effective deterrence against tax evasion.
- 1.4** To identify and plug tax avoidance loop holes through effective tax audits.
- 1.5** To identify areas of tax laws that require clarification. Audits bring to light areas of tax law that may cause confusion and problems to a large number of taxpayers and thus prompting FBR to clarify the laws' requirements and to better educate the taxpayers.
- 1.6** To bring to light information on evasion and avoidance schemes that would be used to mount major counter abuse projects.
- 1.7** To develop institutional framework and time frames for selection, processing and disposal of audit cases.
- 1.8** To identify non compliant taxpayers through developing a modern compliance and risk management system based on risk

identification, analysis of risk characteristics and prioritization in order of importance.

- 1.9** To identify taxpayers most likely to be non compliant through risk scoring techniques.
- 1.10** To develop indicators for determining causal relationship between compliance and taxpayers' characteristics.

Part 2

SCOPE

- 2.1** Audit Policy 2015 shall apply to persons or classes of persons falling under all or any of the three domestic federal tax laws i.e. Income Tax, Sales Tax and Federal Excise Duty and shall provide the necessary frame work for selection of cases for audit by the Board.
- 2.2** For the purpose of selecting cases for audit through computer ballots conducted by the Board, this Policy shall be effective for Tax Year 2014 for Income Tax and corresponding Tax Period(s), i.e from July, 2013 to June, 2014 for Sales Tax and Federal Excise Duty. Besides Tax Year and Tax Period(s) mentioned above, the CIRs may also select cases of persons for audit for Tax Year(s) and or corresponding Tax Period(s), provided the statutory limitations so permit.
- 2.3** It shall set out procedures and guidelines, wherever necessary, for processing the cases of persons and/or classes of persons selected under sections 214C and 177 of the Income Tax Ordinance, 2001, Sections 72B, 38 and 25 of the Sales Tax Act, 1990 and Sections 42B and Section 46 of the Federal Excise Act, 2005.

Part 3

METHODOLOGY

A- Selection of Audit Cases

- 3.1 Selection of cases for audit shall be through random computer ballots conducted by the Board under section 214C of the Income Tax Ordinance, 2001, 72B of the Sales Tax Act, 1990, and 42B of the Federal Excise Act, 2005.
- 3.2 Balloting shall be carried out on data separately for each tax type after exclusion of the cases mentioned in Part 6 of this policy.
- 3.3 The selection of persons or class(es) of persons for audit through computer ballots is normally done once a year by the Board. However, more than one ballots may be held by the Board as and when required.
- 3.4 Apart from persons or class(es) of persons selected for audit by the Board for Tax Year, 2014 and corresponding Tax Periods i.e. 01-07-2013 to 30-06-2014, the Commissioners Inland Revenue may also select cases for audit for any tax year or tax periods under the relevant statutory provisions.
- 3.5 For a particular Tax Year or and corresponding Tax Periods, the Commissioner Inland Revenue shall select a minimum of 5% and up to a maximum of 10% of the cases falling under his jurisdiction.
- 3.6 The Commissioners Inland Revenue shall select a case on the basis of desk audits or risk profiling or both.
- 3.7 If the Commissioner Inland Revenue selects a case for audit, he shall communicate the reasons for initiation of audit proceedings to the taxpayer through a letter under his signature.

- 3.8** Sector studies may be carried out on a continuous basis to determine risk factors and benchmarks.
- 3.9** Based on sector risk analysis and benchmarking studies, a class or classes of persons shall also be selected for audit on random basis through computer ballots by the Board.

B- Processing of Audit Cases

- 3.10** Income Tax Audits pertaining to tax year 2014 and subsequent tax years shall be processed through “IRIS”. Whereas cases of Sales Tax and Federal Excise shall continue to be processed and routed through TAMS until launching of other alternate IT system.
- 3.11** Each and every case shall be entered in to TAMS or IRIS whichever is applicable. **All notices, letters and orders issued to the taxpayers should contain specific bar codes.** Any notice issued or communication made otherwise shall not be construed as valid.
- 3.12** The Commissioner shall assign the audit cases to the relevant team to be headed by an officer of appropriate level. Competence level and Sector expertise of team members may also be kept in view.
- 3.13** Income Tax Manual Part-V and the Sales Tax Audit Hand Book may also be considered while conducting audit.
- 3.14** After consultation with the Commissioner, the head of the audit team must communicate to the taxpayer the discrepancies found in the audit for his explanation before finalizing the audit.
- 3.15** The Commissioners may assign audit cases to the audit team on rational and equitable basis depending upon nature and complexity of the cases.

- 3.16** The procedures and guidelines mentioned in the check-lists and Board's earlier letters should be followed strictly.
- 3.17** Audits are to be conducted fairly and with integrity within the given legal framework without creating unnecessary harassment to the taxpayer.

C-Audit Time Frame

- 3.18** The Board may prescribe a time frame for disposal of cases through administrative instructions from time to time.
- 3.19** It is, however, expected that the cases selected during a financial year would be disposed of during the same year.
- 3.20** In order to complete the audit successfully the role of Chief Commissioner, Commissioners, and Additional Commissioners is of paramount importance. They are not only expected to ensure quick disposal of audits but also maintain a reasonable and respectable level of audit quality by providing suitable guidance and mentoring to the audit teams.

Part 4

Audit Standards & Guide Lines

4.1 It is imperative, for ensuring high quality service to the tax payers, that the tax laws are applied and administered in a reasonable, practical, fair and impartial manner. The audits should, therefore, be conducted within the bounds of law, in a cost effective and efficient manner.

4.2 The following standards should be kept in view at all times while conducting audits:

A. Legality:

Ensure audit activities and conclusions conform to established law and official instructions and guidelines;

B. Objectivity:

Examine all available relevant facts fairly and without any pre-conceived bias. This standard can best be achieved while planning and determining the scope of an audit. Pre-identification, for a particular trade or class of persons, of all the relevant facts to be gathered and verified and additional information to be required during the course of an audit, helps in neutralizing the bias;

C. Timeliness:

Conduct and complete audits within reasonable time and with minimum inconvenience caused to the taxpayer. Moreover the time consumed in terms of hours spent per case by each auditor must be optimally used to

achieve the best possible results. This is particularly relevant when viewed in the perspective of resource constraints.

D. Supportability:

Support recommendations for further action with adequate and justifiable facts and figures. Jumping to conclusions without supporting evidence is neither desirable nor helps the cause of revenue or the taxpayer.

4.3 Guidelines for observing Audit Standards

- Make information requests that are timely, reasonable and of material effect. Consider practicality, costs and alternative acceptable documentation
- Ensure the taxpayer understands why the requested documents are necessary for audit
- Use external and online resources, etc to get information, where ever possible instead of bothering the taxpayer for it
- Avoid duplication of work by preparing timely, organized and clear work papers
- Follow up with taxpayers within 15 days (reasonable time) of last contact or meet any timelines prescribed by the Board
- Establish a positive relationship with the taxpayer to help complete the audit effectively and on time
- Confirm the facts and tax law implications to support the final audit recommendations
- Maintain an Activity Log or an audit trail of what, when and why something was examined during the audit process
- Complete audits within the given time as per work sheet/task plan

Part-5

PERFORMANCE EVALUATION

FBR has consistently strived to automate its audit procedures through business processes re-engineering to increase the audit coverage and to better allocate its resources. To optimize the impact on compliance, resources need to be allocated to balance coverage across taxpayer segment and tax types, yet address major risks to compliance. In order to implement the aims and objective of this policy a separate audit operational plan has been prepared. The said plan, which is on an annual basis, is designed to put in place, among other things, a performance monitoring and evaluation mechanism. The said mechanism lays down qualitative and quantitative indicators for the above purpose. In addition to the performance indicators given below, Key Performance Indicators (KPIs) circulated by the Board on 15th April,2015 shall also be made a basis of performance evaluation of all tiers of officers cadre engaged in the audit activity.

5.1 Quantitative Indicators

- a. No. of cases assigned to each audit officer
- b. No. of cases disposed of per month, per quarter and per year by each audit officer
- c. Time spent (No. of Hours) per case by each audit officer
- d. Comparison of disposal by each audit officer against target. Rate of success in meeting monthly, quarterly and annual disposal targets.
- e. No. of field audits conducted.
- f. No. of cases assigned to each RTO/LTU
- g. No. of cases disposed of per month, per quarter and per year by each RTO/LTU
- h. Comparison of disposal by each RTO/LTU against target. Rate of success in meeting monthly, quarterly and annual disposal targets.

5.2 Qualitative indicators

- a. Average demand raised per case by each audit officer.
- b. Average collection of demand per case by each audit officer.
- c. Amount of demand raised per month, per quarter and per year by each audit officer
- d. Amount of collection out of demand per month, per quarter and per year by each audit officer
- e. Collection out of demand by each audit officer against target. Rate of success in meeting monthly, quarterly and annual disposal targets
- f. Compliance of check-lists and other instructions of the Board.
- g. No. of cases and demand thereof up-held at first appellate forum.
- h. Average amount of tax detected per case through field audits.
- i. No. of cases where avoidance schemes and tax evasion have been identified.
- j. Amount of demand raised per month, per quarter and per year by each RTO/LTU
- k. Amount of collection out of demand per month, per quarter and per year by each RTO/LTU
- l. Collection out of demand by each RTO/LTU against target. Rate of success in meeting monthly, quarterly and annual disposal targets

Part 6

EXCLUSIONS

FBR shall conduct random computer ballot for selection of 7.5 % cases for audit out of the total Income Tax, Sales Tax and FED returns filed for Tax Year 2014 and for corresponding tax periods i.e. 1st July 2013 to 30th June 2014. Certain exclusions have been identified and approved by the Board which pertain to cases where audit is not required for this year. Those exclusions are as under:

6.1 Income Tax Corporate Returns

- a) All person(s) whose entire income is exclusively subject to Final Taxation under the provisions of law as mentioned in sub-section (4) of Section 115 of the Income Tax Ordinance, 2001;
- b) All cases where no business is stated to have been conducted for the relevant tax year and no sales/ receipts have been declared.
- c) All cases already selected for audit for Tax Year 2013 by the Board U/S 214C.
- d) All cases already selected for audit by the CIRs for Tax Year 2014 under section 177(1) of the Income Tax Ordinance, 2001
- e) All cases qualifying for exemption from audit under clause (88) of Part IV of the Second Schedule to the Income Tax Ordinance, 2001 (notwithstanding the omission of said clause through Finance Act, 2014).

6.2 Income Tax Non-Corporate Returns

- a) All person(s) whose entire income is exclusively subject to Final Taxation under the provisions of law as mentioned in sub-section (4) of Section 115 of the Income Tax Ordinance, 2001.
- b) All cases where no sales/ receipts have been declared;
- c) Taxable income from salary only;
- d) Taxable income from share from AOP only;
- e) Cases of pensioners drawing exempt income from pension;
- f) Cases declaring foreign remittances only;
- g) All cases already selected for audit for Tax Year 2013 under section 214C of the Income Tax Ordinance, 2001.
- h) All cases already selected for audit by the CIRs for Tax Year 2014 under section 177(1) of the Income Tax Ordinance, 2001.
- i) All cases qualifying for exemption from audit under clause (88) of Part IV of the Second Schedule to the Income Tax Ordinance, 2001 (notwithstanding the omission of said clause through Finance Act, 2014).
- j) Case(s) of persons(s) where one or more of the above exclusions apply.

6.3 Sales Tax Corporate

- a) Null Return filers,
- b) Federal, Provincial and Local Government Departments;

- c) All cases of Steel Melters, and Steel Re-rollers who are paying sales tax under the Sales Tax Special Procedure Rules, 2007;
- d) All cases of Commercial importers only having no business other than commercial import business and who are paying 3% value added Sales Tax;
- e) All cases already taken up for audit for Tax Period(s) July 2013 to June ,2014 under section 25 ,and 38 of the Sales Tax Act , 1990;
- f) All cases already selected for audit for Tax Period(s) July 2012 to June, 2013 under section 72B of the Sales Tax Act, 1990.

6.4 Sales Tax Non-Corporate

- a) Null Return filers
- b) Federal, Provincial and Local Government Departments
- c) All cases of Steel-Melters, and Steel Re-rollers who are paying sales tax under the Sales Tax Special Procedure Rules, 2007.
- d) All cases of Commercial importers only having no business other than commercial import business and who are paying 3% value added Sales Tax;
- e) All cases already selected for audit for Tax Period(s) July 2013 to June ,2014 under section 25 ,and 38 of the Sales Tax Act , 1990;

- f) All cases already selected for audit for Tax Period(s) July 2012 to June, 2013 under section 72B of the Sales Tax Act, 1990.

6.5 FED Corporate/ Non-Corporate Returns

- a) Null Return filers
- b) Federal, Provincial and Local Government Departments;
- c) All cases already taken up for audit for Tax Period(s) July 2013 to June, 2014 under section 46 of the Federal Excise Act, 2005 Act ;
- d) All cases already selected for audit for Tax Period(s) July 2012 to June, 2013 under section 42B of the Federal Excise Act, 2005.

6.6 The scope of exclusions provided in this policy shall be restricted to cases to be selected for audit u/s 214C of the Income Tax Ordinance, 2001, Section 72B of the Sales Tax Act, 1990 and 42B of the Federal Excise Act, 2005.

GLOSSARY

i.	Additional Commissioner	“Additional Commissioner” means a person appointed as Additional Commissioner Inland Revenue under section 208 of the Income Tax Ordinance, 2001, Section 30 of the Sales Tax Act, 1990 and Section 29 of the Federal Excise Duty Act, 2009 and includes any other authority vested with all or any of the powers and functions of the Additional Commissioner.
ii.	Board	“Board” means the Central Board of Revenue established under the Central Board of Revenue Act, 1924 (IV of 1924), and on the commencement of Federal Board of Revenue Act, 2007, the Federal Board of Revenue established under section 3 thereof;
iii.	Chief Commissioner	“Chief Commissioner” means a person appointed as Chief Commissioner Inland Revenue under section 208 of the Income Tax Ordinance, 2001, Section 30 of the Sales Tax Act, 1990 and Section 29 of the Federal Excise Duty Act, 2009 and includes any other authority vested with all or any of the powers and functions of the Chief Commissioner.
iv	Commissioner	“Commissioner” means a person appointed as Commissioner Inland Revenue under section 208 of the Income Tax Ordinance, 2001, Section 30 of the Sales Tax Act, 1990 and Section 29 of the Federal Excise Duty Act, 2009 and includes any other authority vested with all or any of the powers and functions of the Commissioner.

v.	Null Return	Sales Tax Returns where no business activity has been reported
vi	Person	As defined under section 80 of the Income Tax Ordinance, 2001, Section 2(21) of the Sales Tax 1990.
viii.	Risk Profiling	Risk Profiling : A strategy for audit selection based on identification of taxpayers who are the most likely to be non compliant, through risk scoring techniques, data mining, extrapolating trends, matching of data acquired and developed from information and intelligence from third party sources and other such methods.
ix	Salary	As defined in Section 12 of the Income Tax Act, 2001.
xi	Tax payer	Tax payer means any person who derives an amount chargeable to tax.
xii	Tax Period(s)	As defined in Section 2(43) of the Sales Tax Act, 1990 and it includes corresponding Tax Periods of Tax Years selected for audit.
xiii	Tax Year	As defined in Section 74 of the Income Tax Act, 2001.

AUDIT POLICY 2015 – APPROVAL BY THE BOARD IN COUNCIL

The Audit Policy 2015 was placed before the Board in Council on 11th September, 2015, for consideration and approval. The following Members and Chairman of the Board in Council approved the said Policy:

1. Chairman FBR _____
2. Member (IR-Policy) _____
3. Member (IR-OPS) _____
4. Member (Taxpayers' Audit) _____
5. Member (Legal) _____
6. Member (RAAR) _____
7. Member (Customs) _____
8. Member (Admin) _____
9. Member (SPR&S) _____
10. Member (IT) _____
11. Member (HRM) _____
12. Member (Accounting) _____
13. Member (FATE) _____