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Judgment Sheet

IN THE LAHORE HIGH COURT LAHORE
JUDICIAL DEPARTMENT

Case No. W. P. No. 30253 of 2014

Defence Housing Authority **Versus** Commissioner Inland Revenue, etc.

JUDGMENT

| S.No. of order/ Proceedings | Date of order/ Proceedings | Order with signature of Judge and that of Parties of counsel, where necessary. |
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26.06.2015. Mr. Navid A. Andrabi, Advocate for the petitioner.
M/s. Khurram Shahbaz Butt, Muhammad Mohsin Virk, Tariq Mohmmod, Muhammad Ijaz Ali Bhatti, Sayyid Ali Imran Rizvi, Shahzad A. Elahi, Rana M. Afzal, Muhammad Ajmal Khan, Sumair Saeed Ahmed, H.M. Majid Siddiqui, Mian Ashiq Hussain, Ch. Muhammad Arshad, Sajid Ijaz Hotiana, Imtiaz Rashid Siddiqui, Barrister Shehryar Kasuri & Jamshid Alam, M.M.Akram, and Syed Nasir Ali Gillani Advocates for the petitioners in connected petitions.
M/s Sarfraz Ahmad Cheema, Malik Asad, Advocate on behalf of Mr. Muhammad Ilyas Khan, Advocates for the respondents.
M/s Liaquat Ali Chaudhry, Saeed ur Rehman Dogar, Muhammad Asif Hashmi, Muqtadir Akhtar Shabbir, Ch. M. Tariq, Tariq Saleem Sh. Shahid Sarwar Chahal and Dr. Javed Iqbal Sh. Advocates for the respondents in connected petitions.
Mr. Muhammad Anwar Khan, Advocate for respondent-FBR.
Mr. Tahir Mehmood Ahmad Khokhar, Standing Counsel for Pakistan.
Dr. Ishtiaq Ahmad Khan, Additional Commissioner Inland Revenue, LTU, Lahore.
Syed Ijaz Hussain Shah, Member (Audit) FBR.
Haroon M.K.Tareen, Director General (I&I) Inland Revenue.
Ch. Muhammad Tariq, Director (Law), FBR, Lahore.
Shaukat Hayat Cheema, Secretary (ST&FE-L&P), FBR, Islamabad.

Shahid Jamil Khan, J. This judgment shall also decide connected petitions, detailed *infra*, as common questions of law, under similar facts are being considered.

2. Audit for tax year 2011 is called in question through these petitions. Petitioners were selected for audit by Federal Board of Revenue (“**FBR**”) under Section 214C of the Income Tax Ordinance, 2001 (“**Ordinance of 2001**”) on parametric basis. The selection was challenged before this Court and matter was referred back to FBR for resolution of disputes regarding fairness and reasonability of a parameter itself and controversy that a person selected for audit was not falling under any of the parameters. In *Messrs Ittefaq Rice Mills v. Federation of Pakistan and others* (2013 **PTD 1274**), it was held by learned Division Bench of this Court that selection under a single criteria is sufficient to select a case for audit. However, fairness and neutrality of each case was kept open to be seen in individual case if so required. Relevant para of the judgment is reproduced hereunder:-

“22. FBR shall ensure that in future, the Audit Policy carrying the risk parameters and the mode and manner of segregation through risk analysis for the purposes of parametric balloting is clearly laid out in a policy document. This will help avoid litigation and will also allay the apprehensions of the taxpayers which stem from lack of openness and clarity. It is clarified that we have not gone into the neutrality or the fairness of the individual risk parameter framed by the FBR as it was not challenged before us and can be looked into in some other case.”

3. Thereafter, this selection was again challenged in *JDW Sugar Mills Ltd. v. Federation of Pakistan, etc.* (Writ Petition No.19084 of 2013) mainly for the reason that a stigma was attached to reputation of a business enterprises by selecting it on the basis of high risk parameter and also for the reason that persons were not falling under any of the parameters. With consent of representative of the FBR, a direction was given to constitute High Powered Commission (“**HPC**”) for

resolution of taxpayer's grievances. Unfortunately, the HPC could not satisfy the taxpayers, hence these petitions.

In another set of petitions (which are being decided by a separate judgment) selection for tax year 2012 is challenged. Cases for audit were selected on random basis through computer ballot.

4. Syed Ijaz Hussain Shah, Member (Audit) FBR is present on Court's direction and cases are argued at length in his presence. Different aspects of selecting cases for audit under Section 214C of the Ordinance of 2001 are discussed. The Member (Audit), assisted by other representatives of the FBR, is asked to satisfy the Court about selection for audit on tax year basis out of the filed returns. Muhammad Tarique, Director (Law), FBR, Lahore has read sub-section (7) of Section 177 of the Ordinance of 2001 to contend that a person can again be selected for audit for the next year.

5. The explanation given by Director (Law) FBR is not in consonance with spirit of law. Sub-section (7) of Section 177, is reproduced hereunder:-

"177. Audit-

(7) The fact that a person has been audited in a year shall not preclude the person from being audited again in the next and following years where there are reasonable grounds for such audits."

[emphasis added]

A person audited in a year, can again be selected for audit in the next and following years, where there are reasonable grounds available. It appears that FBR has not understood the spirit of audit under Section 177 read with Section 214C of the Ordinance and parallel provisions under the other statutes. Section 177 reveals that *the Commissioner may call for record or*

documents, maintained under the Ordinance, for conducting an audit of person's income tax affairs.

The record, which can be called for audit is the one maintained under Section 174 of the Ordinance of 2001. Under its sub-section (3), the record shall be maintained for six years. It means, after selection for audit, record of last six years can be called for audit. Sub-section (2) of Section 174 authorizes the Commissioner to disallow or reduce taxpayer's claim of deduction if taxpayer is unable to produce the supporting documents/evidence. The Commissioner, under sub-section (6) of Section 177 is required to obtain explanation, if claim of an expense, deduction or allowance is not supported by any evidence or is found to have been claimed against provisions of the Ordinance of 2001. If satisfactory explanation is not provided, after issuance of notice under Section 122, the assessment or assessments of the years, record of which is audited, can be amended under Section 122(1) or (4) subject to other relevant provisions of same section.

6. Section 214C was inserted in the statute book by Finance Act, 2010. Sub-section (1) of which is reproduced hereunder:-

"214C. Selection for audit by the Board,-(1) The Board may select persons or classes of persons for audit of Income Tax affairs through computer ballot which may be random or parametric as the Board may deem fit."

The powers given to the Board are not new, such powers were available to the Board under Section 59 of the Repealed Income Tax Ordinance, 1979. The Board could select "*persons*" or "*classes of persons*" for total audit (for assessment under normal law) by ousting the taxpayers from Self Assessment Scheme. The Scheme,

under Ordinance of 2001, of treating the return filed by a taxpayer as assessment order under Section 120, is called, generally, as Universal Self Assessment Scheme. FBR has again been given power under Section 214C to select a “persons” or “classes of persons” for audit through computer ballot on random or parametric basis. Selection through random balloting is relatively less controversial, yet some small taxpayers are selected for audit and potential cases are skipped.

The Board, it appears, is unable to evolve an undisputed and transparent policy for selection of cases for audit on parametric basis. Examination of impugned parameters shows that even minor variations, as compared to previous year’s declarations, are made basis for selection of cases. The plea of attaching stigma as raised in JDW Sugar Mills’ Case (supra), is also a matter of concern which is to be considered by the FBR.

7. Basic characteristic of State, as envisaged in Article 7 of the Constitution of Islamic Republic of Pakistan, 1973 is its power to impose tax or cess. Article 77 says that tax shall be levied by or under the authority of Act of Parliament. It is corresponding duty of every citizen or person (as defined in Article 260 of the Constitution) to pay tax in accordance with law (Act of Parliament). Universal Self Assessment Scheme, under Ordinance of 2001, cannot be construed to have given a *carte blanche* to taxpayers, who may declare the tax payable as per their whims. A confidence is reposed on the taxpayer, presuming that payable tax declared in the income tax return is in accordance with law. It is right of the State to audit income tax affairs of a person, at least once in six years, hence his selection for audit cannot be termed as detrimental to his rights.

Nevertheless, power of FBR to select for audit is not unbridled, the discretion has to be exercised justly, fairly and in transparent manner. The Apex Court in Government of NWFP through Secretary and 3 others v. Majee Flour Mills (Private) Limited (1997 SCMR 1804), while following its earlier decision in Amanullah Khan and others v. The Federal Government of Pakistan through Secretary, Ministry of Finance, Islamabad and others (PLD 1990 SC 1092), has reiterated the doctrine of “*structuring the discretion*”.

Doctrine of structuring discretion was explained in Amanullah Khan's case, in following words:-

“structuring discretion only means regularizing it, organizing it, producing order in it so that decision will achieve the high quality of justice.”

Seven instruments were highlighted, which are useful to structure discretionary power i.e. “*open plans, open policy statement, open rules, open findings, open reasons, open precedents and fair in formal procedure*”. Framing of Rules to regulate the discretionary power was emphasized. The expression of Hon’ble Court is reproduced:-

“the wide-worded conformant of discretionary powers of reservations of discretion, without framing rules to regulate its exercise, has been taken to be an enhancement of power and it gives that impression in the first instance but where the authorities fail to rationalize it and regulate it by Rules, or Policy statement or precedents, the Courts have to intervene more often, than is necessary, apart from the exercise of such power appearing arbitrary and capricious at times.”

Needless to say that FBR is bound to structure the discretion vested in it under Section 214C of the Ordinance and under parallel provision of Sales Tax Act 1990 and Federal Excise Act 2005. Federal

Government, so far, has not been able to frame Rules to regulate FBR's discretion and FBR has not given any procedure. A taxpayer, selected for audit is left on the mercy of an unskilled audit officer for conducting audit. I am constrained to observe that FBR's tax year based selection for audit is tainted with an intention to achieve budgetary targets, therefore, is creating panic amongst the taxpayers, who are rushing to Courts after their selection. One of the reasons for challenging each case of selection under audit appears that department has not come out of the mind set of assessment under the Repealed Ordinance of 1979. After selection of taxpayers, the additions are made on gross-profit and parallel cases basis. Even estimations are made, which are alien to the new concept of amending assessment under Ordinance of 2001.

It is reiterated that primary object of audit is to create deterrence for the taxpayers. Taxpayers, besides having confidence in audit procedures, should believe that they would be penalized and subjected to additional tax, if wrong declaration is detected in an audit of their six year's record. Taxpayers should be made to believe that their case shall surely be selected for audit at least once in six years. Taxpayers can even be given an option to volunteer for audit. As ordained by Hon'ble Supreme Court, in the referred cases, FBR needs to frame Rules, keeping in view the doctrine of "*structuring the discretion*". If FBR fails to rationalize and regulate powers of selecting and conducting audit through Rules, the Courts might intervene more often than is necessary to undo an exercise of power, appearing arbitrary and capricious at times.

8. History of litigation relating to audit for tax year 2011 shows that number of attempts, to make Committees and Review Panels have failed. If a person, selected on high risk based criteria, has denied to be covered by that criteria, the matter needs resolution after providing opportunity of being heard. Two types of grievances are highlighted in these cases; one that the parameter is not high risk based and that the taxpayer is not falling under the criteria.

9. These cases are referred to Syed Ijaz Hussain Shah, Member (Audit) for his examination and decision in his personal capacity. All the petitioners shall send their representations alongwith supported documents to the Member. The Member (Audit) shall examine each case at his end and in case he forms an opinion that taxpayer was wrongly selected, he shall pass order accordingly. If his opinion is otherwise, he shall summon the taxpayer and shall provide an opportunity of being heard and thereafter a speaking order shall be passed. The needful shall be done within 60 days. If in his opinion, after hearing the taxpayer a parameter is not highly risk based, he shall drop the selection, on such parameter.

The Member (Audit), present in Court, shall abide by the direction of this Court whether he holds the post as Member (Audit) or not and Board shall facilitate him in this regard.

Disposed of.

This judgment shall also decide Writ Petition Nos. 30434, 30296, 30331, 31008, 31693, 31203, 31235, 31267, 32233, 31519, 33900, 33272, 34327, 31621, 30875, 30877, 31517, 31354, 31266, 31370, 31520, 31009, 31256, 31421, 31981, 31371, 33581,

33173, 33956, 33586, 33255, 34534, 34241, 31013,
34234, 32382 of 2014, 164 and 256 of 2015.

(Shahid Jamil Khan)
Judge

APPROVED FOR REPORTING

JUDGE

Sharif