

Judgment Sheet

IN THE LAHORE HIGH COURT LAHORE
JUDICIAL DEPARTMENT

Case No: W.P. No.393/2012.

M/s Chenone Stores Ltd. **Versus** The Federal Board of
Revenue, etc.

JUDGMENT

Date of hearing:	10.05.2012.
Petitioners represented by:	M/s. Shahbaz Butt, Rana Muhammad Afzal, M. M. Akram, M. Iqbal Hashmi, Dr. Ilyas Zafar, Syed Ibrar Hussain Naqvi, Muhammad Naeem Shah, Mian Masood Ahmad, Javed Iqbal Qazi, Usman Javed Qazi, Ch. Anwaar-ul-Haq-I, Khawaja Farooq Saeed, Muhammad Siddique Rana, Imtiaz Rashid Siddiqui, Shaharyar Kasuri, Sajid Ijaz Hotiana, Jan Muhammad Chaudhry, Muhammad Ajmal Khan, Muhammad Farooq Sheikh, Rana Munir Hussain, Muhammad Shahid Mukhtar Chandia, Tariq Saleem Sheikh, Abdul Waheed Habib, Muhammad Younas Khalid, Mian Mahmood Rashid, Muhammad Aleem Irshad, Sami Ullah Zia, Mudassar Shujauddin, Asghar Ahmed Kharl, Muhammad Ijaz Ali Bhatti, Habib-ur-Rehman, H. M. Majid Siddiqi, Malik Ahsan Mehmood, Muhammad Javaid Iqbal Qureshi, Muhammad Mohsin Virk, Muhammad Arif Mallhi, Ch. Muhammad Aslam, Shahzad Mahmood Butt, Sohail Ibne Siraj, Muhammad Younas Khalid, Ch. Muhammad Naveed Shabbir Goraya, Zahid Ateeq Ch., Zurgham Lukhesar, Muhammad Nadeem, Muhammad Nauman Yahya, Barrister Khurram Raza, Saleem Iqbal Rathore, Agha Sarfraz Ahmad, Suhail Raza, Shahbaz Siddique, Ahsan Khan Yusufi, Nawazish Ali, Muhammad Naeem Munawar, Mian Muhammad Hussain Chotya, Hashim Aslam Butt, Ch. Muhammad Arshad, Agha Sarfraz Ahmed, Muhammad Ejaz, Ghulam Murtaza, Rasheed Ahmed Sheikh, Munawar us Salam, Mirza Anwar Baig, Malik Abdul Qadir Jsra, Ahmed Naseer Sheikh, Shahid Usman, Shakeel Ahmad Basra, M. Shahid Umar Khan, Muhammad Waseem Ch, Sayyid Ali Imran Rizvi,

	Ghazanfar Farookh, Shahzad Mahmood Butt, Muhammad Anwar Bhatti, Ch. Mumtaz-ul-Hassan, Mohammad Azhar Siddique, Syed Naeem-ud-Din Shah. Shoaib Ahmed Sheikh, Ch. Muhammad Ali, Muhammad Shahid Baig, Naeem Khan, Mian Abdul Ghaffar, Muhammad Ahsan Virk, Rana Muhammad Aslam, Syed Irfan Haider, Mohsin Afzaal Hashmi, M. Farooq Khokhar, Iftikhar Ahmad Khan, Abdul Qaddus Mughal, Muhammad Mansha Sukhera, Zia Shahid Waseer and Mian Faheem Bashir, Advocates.
Respondents represented by:	M/s. Muhammad Ilyas Khan, Ch. Pervaiz Iqbal Gondal (Standing Counsel), Ehsan-ur-Rehman Sheikh., Monam Sultan, Raja Sikandar Khan, Muhammad Asif Hashimi, Sarfraz Ahmad Cheema, Ms. Kausar Parveen, Mian Yousaf Umar, Sajjad Haider Rizvi, Saeed-ur-Rahman Dogar, Mian Asghar Ali Gurdaspuri, Muhammad Yahya Johar, M. Yusuf Akram, Zaheer-ul-Hassan Zahoor, Khadim Hussain Zahid, Sohail Zahid Butt, Amjad Hussain Malik, Agha Muhammad Akmal Khan and Tariq Manzoor Sial, Advocates. Mr. Mohammad Aqil Usman, Member Legal FBR. Dr. Tariq Masood, Additional Commissioner, FBR (HQ), Karachi. Mr. Yousif Hyder Shaikh, Additional Commissioner FBR (HQ) Karachi.
Court assisted by:	Mr. Asim Zulifqar, <i>amicus curiae</i> .
Research assistance by:	Mr. Nadeem Ahmed Sohail Cheema, learned Civil Judge/Research Officer, Lahore High Court Research Centre (LHCRC).

Syed Mansoor Ali Shah, J:- This consolidated judgment decides the instant petition, as well as, petitions mentioned in Schedule A to this judgment, as common questions of law and facts arise in these cases.

2. Brief facts are that notice under Section 177(1) of the Income Tax Ordinance, 2001 (“Ordinance”) for the Tax Year 2010, dated 23-11-2011, has been served on the petitioner by the concerned Commissioner of the Inland Revenue whereby the petitioner has been practically selected for audit of its tax affairs and asked to furnish record for further verification. Similarly, petitioner in W.P. No. 11460/2012 has been served with a composite notice for audit under section 25 of the Sales Tax Act, 1990 (“STA”) and Section 46 of the Federal Excise Act, 2005 (“FEA”) dated 14.12.201 by the concerned Commissioner of the Inland Revenue, selecting the said petitioner for audit for period between July, 2009 to June 2010. These Notices have been reproduced in Schedule C to this judgment for ready reference.

3. The grievance of the petitioners (in the two sets of cases mentioned above) is that the impugned notices issued by the concerned Commissioners Inland Revenue directing the petitioners to produce record for the tax years amounts to selecting the petitioners for audit of their tax affairs. It is submitted that selection of a taxpayer for audit of its tax affairs without an objective criteria offends the equity clause and thus not permissible under the law. Learned counsel argued that the amendments brought about in the three tax laws, through Finance Act, 2010 namely; Section 214C of the Ordinance, 42B of the FEA and section 72B of the STA empower Federal Board of Revenue (“FBR”) to select cases for audit and the powers of the Commissioner have been restricted and reduced to mere

conducting of the audit of the taxpayers, after the cases have been selected by the FBR.

4. Learned amicus curiae, Mr. Asim Zulfiqar, Chartered Accountant, A.F. Ferguson & Co., Lahore traced the amendments brought about in Section 177 of the Ordinance since its promulgation. He submitted that the presence of an objective criteria for selection is a pre-condition for initiating audit and referred to the legislative history of section 177 to establish his point. He submitted that initially the power to select cases for audit on the basis of a statutory objective criteria was the sole prerogative of the Commissioner (i.e., from 13-9-2001 to 29-6-2004). Then for a certain period the Central Board of Revenue (as it then was) was empowered to lay down criteria for selection of any person for audit of its income tax affairs and the Commissioner enjoyed the power to select the person for audit on the basis of the said criteria in addition to the statutory criteria provided to the Commissioner (i.e., from 30-6-2004 to 27-10-2009). Subsequently, the concept of “selection” was practically removed from section 177 alongwith its supporting “statutory objective criteria.” This position continued till Finance Act, 2010, whereby section 214C was inserted w.e.f 5-6-2010¹ empowering the FBR to select a person for audit of income tax affairs through computer ballot which may be random or parametric as FBR deems fit. All these legislative amendments have been reproduced in Schedule B to this judgment for convenience and ready reference.

¹ See Section 8 Clause (55) of Finance Act, 2010.

5. Learned amicus curiae submitted that after the insertion of the amendments through Finance Act, 2010 it is the FBR that enjoys the exclusive power to select a person for audit of its tax affairs and the powers of the Commissioners are to conduct the audit once the selection is made. Selection for audit, being a substantive power, is enjoyed by the FBR, while the procedural power of conducting the audit rests with the Commissioner concerned. He submitted that the power of selection has been withdrawn from the Commissioner and it is evident from the deletion of the selection criteria provided in section 177(4) (a) to (d) of the Ordinance. In order to clarify the important link between selection and the objective criteria he pointed out that, as long as, the Commissioner was permitted under the law to make the selection of a person for audit of its tax affairs, he was also provided with a statutory objective criteria to regulate the selection process. Learned amicus curiae submitted that scope of section 177 came under repeated litigation before the superior courts and placed reliance on Ch. Muhammad Hussain and others v. Commissioner of Income-Tax, (2005 PTD 152), Commissioner of Income Tax and others v. Fatima Sharif Textile, Kasur and others, (2009 PTD 37), Mohsin Raza v. Chairman, Federal Board of Revenue and others, (2009 PTD 1507), Messrs Sadar Anjuman-e-Ahmedia through General Attorney v. Commissioner of Income Tax (Audit Division), Faisalabad and 3 others, (2010 PTD 571) and Chairman FBR and others etc. v. Idrees Traders etc. [(2011) 103 Tax 131 (S.C. Pak.)] to highlight that the superior courts have stressed time and again that

selection of audit must be on the basis of an objective criteria. In case of Sales Tax, learned amicus curiae submitted that section 25 is subject to section 72B, in as much as the selection for audit has to be done by the Board and once the selection is made only then the process of audit can be initiated by the Commissioner. Similar is the case under the Federal Excise Act, 2005 where under section 42B selection for the audit is to be done by the Board while the audit has to be conducted by the Commissioner under section 46. He submitted that almost identical amendments in the three tax laws is an effort towards harmonization of the three taxes, hence the interpretation of Income Tax law also holds good for the other two tax laws i.e., Sales Tax and Federal Excise Duty.

6. Mr. Shahbaz Butt, Advocate, learned counsel for the petitioner, while supplementing the submissions of the amicus curiae, argued that the investigative powers of the tax regulator are almost the same as provided in the Income Tax Ordinance, 1979. The only difference in the two legislative frame works is that, under the Ordinance, the tax return filed by the taxpayer is deemed to be an assessment order under section 120. He referred to Sections 120, 121, 122, 174, 175 and 176 to submit that there are immense powers with the department to investigate the affairs of the taxpayer. He vehemently underlined that investigative powers of the tax regulator are distinct set of powers and cannot be treated at par with the non-invasive audit function of the department under sections 177 and 214C of the Ordinance. He

submitted that the audit function is a neutral and impartial inquiry to assess the effective compliance of the tax system.

7. Additional Commissioner appearing on behalf of the respondent department vehemently submitted as follows:

- i. The Ordinance is a paradigm shift from the previous Income Tax Ordinance, 1979. Under the new dispensation the tax return filed automatically becomes an assessment order of the taxpayer. This new system of self-assessment is based on trust and simultaneously requires a vigilant audit function to check compliance.
- ii. That the concept of “selection” for audit has been dispensed with vide Finance Ordinance, 2009 w.e.f. 28.10.2009 hence it cannot be read into Section 177. Any such interpretation is against the principle of literal interpretation. It is settled principle of law that courts are bound to interpret and apply provisions of the law as they stand without going behind the wisdom of legislature. He placed reliance on Padmasundara Rao (Decd.) and others v. State of Tamil Nadu and others (255 ITR 147) and Kishore B. Setalvad v. Commissioner of Wealth-Tax (256 ITR 637). He further argued that superior courts in Pakistan, as well as in India have on a number of occasion held that courts ought not under any circumstances substitute their own impressions, ideas and notion of the justice in place of the legislative intent as available from a plain reading of the statutory provision. He placed reliance on The Punjab Province v. Malik Khizar Hayat Khan Tiwana (PLD 1956 FC 200), Commissioner of Income Tax, Companies-I, Karachi v. Messrs National Investment Trust Ltd., Karachi (2003 PTD 589), Pakistan Lyallpur-

Samundri Transport Co. Ltd., Lahore v. Commissioner of Income-Tax, Lahore Zone, Lahore (1980 PTD 69), Pervaiz Akhtar and another v. The Additional District Judge, Rawalpindi and 4 others (PLD 1990 SC 681) and State and another v. Sajjad Hussain and others (1993 SCMR 1523).

- iii. Concept of selection which was in the statute since 2003 up to October, 2009 was deliberately removed and therefore, the said concept cannot be read into the statute against the express legislative resolve. He placed reliance on *Pakistan Lyallpur-Samundari Transport Co. Ltd. Lahore v. Commissioner of Income Tax, Lahore Zone, Lahore [(1982) 46 TAX 143 (H.C. Lah.)]* and *Shashikant Laxman Kale and another v. Union of India and another (185 ITR 104)*.
- iv. The Legislature in its own wisdom and in an attempt to harmonize Income Tax Law with other inland statutes like Sales Tax Act, 1990 and Federal Excise Act, 2005 enlarged/broadened the powers of the Commissioner by dispensing with the process of selection and enabling him to directly call for books of accounts for conducting audit. This is in line with similar concept under Section 25 of the Sales Tax Act, 1990 and Section 46 of the Federal Excise Act, 2005.
- v. Finance Act, 2010 brought a new concept by empowering Federal Board of Revenue to select persons or classes of persons for conducting audit through computer balloting not only in the Income Tax Ordinance, 2001 but also under Sales Tax Act, 1990 and Federal Excise Act, 2005 by inserting sections 72B and 42B, respectively. These amendments do not affect the inherent powers of the

Commissioner for calling for books of accounts and conduct audit of the taxpayer.

- vi. If argument of the petitioner is taken to be correct that without selection under Section 214C of the Ordinance audit cannot be conducted under Section 177 then the first proviso of Section 177 becomes redundant which cannot be justified by any cannon of interpretation.

8. Mr. Muhammad Ilyas Khan, Advocate on behalf of the department submitted² as follows:

- a. To understand the concept of audit under the scheme of Income Tax Ordinance, 2001 it is necessary that relation between State, citizens and tax be kept in mind. Tax on income is imposed at a certain percentage of income by the State having inherit right to impose taxes. This percentage is in fact the share of State in the income earned by its subjects in lieu of its responsibilities towards citizens. So the State is a shareholder/partner in the income.
- b. Being a share holder in the income of its subjects, the State has the right to know as to whether due share is being paid to it or not, particularly in the circumstances where the right to determine such share has been bestowed upon the taxpayer under the Universal Self Assessment Scheme. Income Tax Ordinance, 2001 has provided mechanism in the form of audit under the provisions of Section 177 where the State can verify its share through its functionary i.e., the Commissioner who is empowered to conduct audit at his own or in pursuance of selection of case of a person by the Board under Section 214C.

² According to parawise comments filed in Writ Petition No.608/2012.

- c. The selection of a case or calling of record for audit in no way causes any prejudice to the interest of a taxpayer as audit is nothing but a verification of the correctness of the share of the State and meant to safeguard the proper interest of the State. In the broader sense audit of a taxpayer is only a way to safeguard the interest of more than 180 million people of the country, represented by the government through their chosen representatives and any method whatsoever employed to hamper the process of audit will not only cause prejudice to the State but also be a direct infringement of the rights of 180 million people.
- d. The Universal Self Assessment Scheme (USAS) has to be backed by strong audit. A trust has been reposed on the taxpayer by providing USAS whereby the return filed by the taxpayer under Section 114 of the Ordinance constitutes an assessment under Section 120 of the Ordinance. To conduct audit is just to keep a check on the veracity of the declaration made in the return. No prejudice is caused to the taxpayer by audit of its tax affairs. Law provides for an objective accountability in the form of audit under Section 177 of the Income Tax Ordinance, 2001. He placed reliance on Messrs Syed Bhais (Pvt.) Ltd. through Director v. Central Board of Revenue, Islamabad through Chairman and another (2007 PTD 239) in support of the above contention.
- e. Under the first proviso to sub-section (1) of Section 177 of the Ordinance, Commissioner can call record for the purpose of audit after recording reasons in writing and these reasons have to be communicated to the taxpayer whereas in case of selection of a case by the Board under Section 214C the Commissioner is not required to record

and communicate the reasons for calling of record for the purpose of audit.

- f. The scope of section 214C is clearly different from section 177. Under Section 214C the Board has the power of selection by taking a holistic view whereas under sub-section (1) of Section 177 the Commissioner is empowered to call for the record either after selection of persons for audit by the Board or at his own notion by examining each case and recording reasons thereof for the purpose of audit.

All the other learned counsel representing the respondent department in other petitions adopted the arguments of Mr. Muhammad Ilyas Khan, Advocate.

9. Arguments heard. Record perused.
10. The questions that require determination by this Court are:
 - i. Whether COMMISSIONER INLAND REVENUE is entitled to SELECT a person/taxpayer for the purposes of audit of its tax affairs under section 177(1) or its first proviso [177(1)(a)], section 25(2) and section 46(1) under the Ordinance, STA and FEA, respectively? Especially, in the wake of the simultaneous and identical amendments brought about in all the three tax laws through Finance Act, 2010 whereby sections 214C, 42B and 72B have been introduced in the Ordinance, STA and FEA, respectively, exclusively vesting FBR with the power to SELECT a person/taxpayer for audit of its tax affairs?
 - ii. Whether the unguided and unbridled power of the Commissioner to pick and choose any taxpayer/person under section 177(1) alongwith its first proviso, section 25(2) and section 46(1) of the Ordinance, STA and FEA,

respectively for audit of its tax affairs is *ex-facie* discriminatory, hence violative of the fundamental right guaranteed to the petitioners under article 25 of the Constitution?

- iii. Whether the aforesaid provisions and the exercise of power by the Commissioner thereunder impairs and disfigures the neutrality and purpose of audit by unlawfully morphing it into an investigative power. Hence, targeting specific taxpayers thereby offending the legislative policy of self assessment and voluntary compliance?
- iv. Whether audit provisions under sections 177(1), 46(1) and 25(2) of the Ordinance, FEA and STA, respectively, have a much wider scope of inquiry as compared to the investigative powers?

11. The relevant provisions carrying the amendments introduced through the Finance Act, 2010 are reproduced hereunder for ready reference:

Income Tax Ordinance, 2001	Sales Tax Act, 1990	Federal Excise Act, 2005
<p>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 it.</p> <p>(2) Audit of Income Tax affairs of persons selected under sub-section (1) shall be conducted as per 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.</p> <p>(3) For the removal of doubt it is hereby declared that Board shall be deemed always to have had the power to select any persons or classes of</p>	<p>72B. Selection for audit by the Board.- (1) The Board may select persons or classes of persons for audit of tax affairs through computer ballot which may be random or parametric as the Board may deem fit.</p> <p>(2) Audit of tax affairs of persons selected under sub-section (1) shall be conducted as per procedure given in section 25 and all the provisions of this Act shall apply accordingly.</p> <p>(3) For the removal of doubt, it is hereby declared that the Board shall be deemed always to have had the power to select any persons or classes of persons for audit of tax affairs under this section.</p>	<p>42B. Selection for audit by the Board.— (1) The Board may select persons or classes of persons for audit of records and documents through computer ballot which may be random or parametric as the Board may deem fit.</p> <p>(2) Audit of such persons selected under sub-section (1) shall be conducted as per procedure given in section 46 and all the provisions of the Act shall apply accordingly.</p> <p>(3) For the removal of doubt, it is hereby declared that Board shall be deemed always to have had, the power to select any persons or classes of persons for audit.</p>

persons for audit of Income Tax affairs.]		
<p>177 Audit.- (1) The Commissioner may call for any record or documents including books of accounts maintained under this Ordinance or any other law for the time being in force for conducting audit of the income tax affairs of the person and where such record or documents have been kept on electronic data, the person shall allow access to the Commissioner or the officer authorized by the Commissioner for use of machine and software on which such data is kept and the Commissioner or the officer may have access to the required information and data and duly attested hard copies of such information or data for the purpose of investigation and proceedings under this Ordinance in respect of such person or any other person: Provided that-</p> <p>(a) the Commissioner may, after recording reasons in writing call for record or documents including books of accounts of the taxpayer; and</p> <p>(b) the reasons shall be communicated to the taxpayer while calling record or documents including books of accounts of the taxpayer: Provided further that the Commissioner shall not call for record or documents of the taxpayer after expiry of six years from the end of the tax year to which they related.</p> <p>(2) After obtaining the record of a person under sub-section (1) or where necessary record is not maintained, the Commissioner shall conduct an audit of the income tax affairs (including examination of accounts and records, enquiry into expenditure, assets and liabilities) of that person or any other person and may call for such other information and documents as</p>	<p>25. Access to record, documents, etc.-</p> <p>(1) A person who is required to maintain any record or documents under this Act or any other law shall, as and when required by Commissioner, produce record or documents which are in his possession or control or in the possession or control of his agent: and where such record or documents have been kept on electronic date, he shall allow access to the officer of Inland Revenue authorized by the Commissioner and use of any machine on which such date is kept.</p> <p>(2) The officer of Inland Revenue authorized by the Commissioner, on the basis of the record, obtained under sub-section (1), may, once in a year, conduct audit: Provided that in case the Commissioner has information or sufficient evidence showing that such registered person is involved in tax fraud or evasion of tax, he may authorize an officer of Inland Revenue, not below the rank of Assistant Commissioner, to conduct an inquiry or investigation under section 38.</p> <p>Provided further that nothing in this sub-section shall bar the Officer of Inland Revenue from conducting audit of the records of the registered person if the same were earlier audited by the office of the Auditor-General of Pakistan.</p> <p>(3) After completion of audit under this section or any other provision of this Act, the officer of Inland Revenue may, after obtaining the registered person's explanation on all the issues raised in the audit shall pass an order under section 11 or section 36, as the case may be.</p> <p>(4) Omitted</p> <p>(4A) After completion of the audit under this section or any</p>	<p>46. Departmental Audit.-</p> <p>(1) The officer of Inland Revenue authorized by the Board or the Commissioner, by designation may, once in a year, after giving advance notice in writing, conduct audit of the records and documents of any person registered under this Act.</p> <p>(2) In case the Commissioner has information or sufficient evidence showing that such registered person is involved in fraud or evasion of duty, he may authorize an officer of Inland Revenue, not below the rank of Assistant Commissioner, to conduct audit at any time in a year.</p> <p>(2A) After completion of the audit under this section or any other provision of law, the officer of Inland Revenue may, after obtaining the registered person's explanation on all the issues raised in the audit shall pass an order under section 14, imposing the amount of duty as per law, charging default surcharge, imposing penalty and recovery of any amount erroneously refunded.</p> <p>(3) Notwithstanding the penalties prescribed in section 19, if a registered person wishes to deposit the amount of duty not paid, short paid or the amount of duty evaded along with default surcharge voluntarily, whenever it comes to his notice, before commencement of audit, no penalty shall be recovered from him:</p> <p>Provided that if a registered person wishes to deposit the amount of duty not paid, short paid or amount of duty evaded along with default surcharge during or after the audit but before the determination of liability under sub-section (2A), he may deposit such amount along with twenty five percent of the amount of penalty</p>

<p>he may deem appropriate.</p> <p>(3) Omitted. (4) Omitted. (5) Omitted. (Sub-sections (3) to (5) omitted by Finance Act.2010. (6) After completion of the audit, the Commissioner may, if considered necessary, after obtaining taxpayer's explanation on all the issues raised in the audit, amend the assessment under sub-section (1) or sub-section (4) of section 122, as the case may be.</p> <p>(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.</p> <p>(8) The Board or the Commissioner may appoint a firm of Chartered Accountants as defined under the Chartered Accountants Ordinance, 1961 (X of 1961) or a firm of Cost and Management Accountants as defined under the Cost and Management Accountants Act, 1966 (XIV of 1966), to conduct an audit of the income tax affairs of any person or classes of persons and the scope of such audit shall be as determined by the Board or the Commissioner on a case to case basis.</p> <p>(9) Any person employed by a firm referred to in sub-section (8) may be authorized by the Commissioner, in writing, to exercise the powers in sections 175 and 176 for the purposes of conducting an audit under that sub-section.</p> <p>(10) Notwithstanding anything contained in sub-sections (2) and (6) where a person fails to produce before the Commissioner or a firm of Chartered Accountants or a firm of Cost and Management Accountants appointed by the</p>	<p>others provision of law, the officer of Inland Revenue may, if considered necessary, after obtaining the registered person's explanation on all the issues raised in the audit shall pass an order under section 11 or section 36, as the case may be, imposing the correct amount of tax, charging default surcharge, imposing penalty and recovery of any amount erroneously refunded.</p> <p>(5) Notwithstanding the penalties prescribed in section 33, if a registered person wishes to deposit the amount of tax short paid or amount of tax evaded along with default surcharge voluntarily, whenever it comes to his notice, before receipt of notice of audit, no penalty shall be recovered from him:</p> <p>Provided if a registered person wishes to deposit the amount of tax short paid or amount of tax evaded along with default surcharge during the audit, or at any time before issuance of show cause notice, he may deposit the evaded amount of tax, default surcharge under section 34, and twenty five per cent of the penalty payable under section 33:</p> <p>Provided further that if a registered person wishes to deposit the amount of tax short paid or amount of tax evaded along with default surcharge after issuance of show cause notice, he shall deposit the evaded amount of tax, default surcharge, under section 34, and full amount of the penalty payable under section 33 and thereafter, the show cause notice, shall stand abated.</p>	<p>prescribed under this Act or the rules made there under and in such case, further proceedings in the case shall abate.</p> <p>(4) The Board may appoint a Chartered Accountant or a Cost and Management Accountant or a firm of such accountants to conduct audit of a person liable to pay duties under this Act in such manner and subject to such conditions it may specify.</p> <p>(5) The audit of the registered person shall generally be a composite audit covering all duties and taxes to which his business or activity is liable under the laws administered by the Board.</p>
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<p>Board or the Commissioner under sub-section (8) to conduct an audit, any accounts, documents and records, required to be maintained under section 174 or any other relevant document, electronically kept record, electronic machine or any other evidence that may be required by the Commissioner or the firm of Chartered Accountants or the firm of Cost and Management Accountants for the purpose of audit or determination of income and tax due thereon, the Commissioner may proceed to make best judgment assessment under section 121 of this Ordinance and the assessment treated to have been made on the basis of return or revised return filed by the taxpayer shall be of no legal effect.</p>		
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(Emphasis supplied)

12. There is no cavil with the proposition, on either side, that FBR now has the power under sections 214C, 42B and 72B of the Ordinance, STA and FEA, respectively, to SELECT a person for audit of its tax affairs through computer ballot which may be random or parametric.

13. In order to examine the questions framed above, I start with the examination of the audit function under the Income Tax Ordinance, 2001, first.

Income Tax Ordinance, 2001.

14. In order to examine the power of the Commissioner under section 177(1) and its first proviso it is important to review the legislative history of this section as punctuated by judicial

interpretation over the years. Review of these amendments show that in the beginning (from 13-9-2001 to 30-6-2002) Commissioner enjoyed the power to SELECT a taxpayer for audit on the basis of an OBJECTIVE CRITERIA supplied in sub-sections 1(a) to (d) of section 177 (as it then was). The Central Board of Revenue (as it then was) also enjoyed power under section 177(3) of the Ordinance to appoint a firm of chartered accountants to conduct an audit of the income tax affairs of any person. Power to SELECT a taxpayer for audit, however, mainly lay with the Commissioner. During the period 1-7-2002 to 29-6-2004 the same position continued except with the insertion of sub-sections 177 (1-A) and (1-B) through Finance Ordinances, 2002 and 2003 which further streamlined the process of audit by emphasizing that audit be CONDUCTED once the taxpayer is SELECTED for audit and in case of discrepancy the assessment be amended.

15. Through Finance Act, 2004, CBR was specifically given the power to lay down a criteria for selection of any person for audit of its tax affairs. Additionally, the Commissioner could select a person for audit on the basis of the criteria framed by the CBR or according to the statutory selection criteria given in sub-section 177(4) (a) to (d). This position continued till 30-6-2009. Through Finance Act, 2009 the Commissioner enjoyed the power to SELECT a person for audit according to the criteria laid down by the CBR or according to the statutory criteria under section 177(4)(a) to (d) of the Ordinance.

However, surprisingly, sub-section 177(8) (as it stood on 1-7-2009) states that CBR may appoint a firm of chartered accountants to conduct an audit of the income tax affairs of a person selected for audit by the Commissioner or by the Board of Revenue. Under Finance (Amendment) Ordinances, 2009 and 2010 the word “select” was dispensed with in section 177(1) and the Commissioner was vested with the power to call for the record of any case for **conducting the audit** of the income tax affairs of any person. More importantly, the statutory criteria for selecting a taxpayer for audit by the Commissioner (provided in section 177) was also deleted. However, sub-section 177(8) [as it stood on 28-10- 2009] provided that Board may appoint a firm of Chartered Accountants or a firm of Cost and Management, Accountants to conduct audit of the income tax affairs of any person or classes of persons selected for audit by the Commissioner or by the Board (no criteria of selection is provided in the said section).

16. On 1-7-2010 under Finance Act, 2010 the status of section 177 remained largely the same except the introduction of the first proviso to section 177(1) (a) (b) which provided that in case records are called from a taxpayer as opposed to a “person” in section 177(1), the Commissioner will record reasons in writing for doing so. The words “selected for audit” under sub-section 177(8) were removed. Finance Act, 2010 also introduced section 214C in the Ordinance. This section reintroduced and reinforced the concept of SELECTION and

empowered FBR to select a person for audit on the basis of computer ballot, which is either random or parametric. Additionally, section 214C provides that once the taxpayer is selected for audit, the said audit is to be conducted as per procedure provided in section 177 and all the provisions of the Ordinance, except the first proviso of sub-section(1) of section 177 shall apply.

17. Revisiting the legislative amendments made, over years, in section 177, show that from 13.09.2001 till 27.10.2009, the said section clearly provided that a taxpayer had to be SELECTED for audit by the Commissioner on the basis of statutory criteria developed by the CBR or on the basis of the statutory criteria under sub-section 177(4)³. The legislative evolution of section 177 shows that selection for audit is always based on a pre-selection criteria and that selection precedes the machinery procedure of conducting the audit. After Finance Act, 2010 the power to SELECT a person for audit shifted to FBR while the concept of selection was removed from section 177 and so was its supporting statutory criteria. The first proviso to Section 177(1), which is excluded from the ambit of section 214C, provides that the Commissioner, after recording reasons in writing, call for the record of a taxpayer.

18. The respondent department stands on this proviso to interchangeably claim an independent power to either audit or investigate any taxpayer provided reasons for the same are recorded in

³ except the language employed in sub section 177(8) as it stood from 1-7-2009 to 30.6.2010.

writing. The departmental representative took pains to reiterate and emphasize that the concept of audit and investigation converge in this proviso, denuding audit of its historical meaning. It has been vehemently argued by the departmental representative that under section 177(1) or its first proviso there is no requirement of “selection” for audit and the Commission can simply call for the record of any person and, under the first proviso, of any taxpayer after recording reasons in writing. It is submitted that this power is in addition to the power of the FBR under section 214C as the existing investigative powers are not sufficient for the purposes of carrying out an indepth inquiry.

19. In contradistinction, the respondent department, in the comments filed before this Court states that the power of audit is just to keep a check on the veracity of the declaration made by the taxpayer in the return. It is submitted that there is no prejudice caused to the taxpayer by audit of its tax affairs as the law provides for an objective accountability in the form of audit under Section 177 of the Income Tax Ordinance, 2001.⁴

20. A quick review of the case law, hereunder, on section 177 of the Ordinance, over the years and prior to Finance Act, 2010, shows that the courts have consistently held that “objective criteria” is a pre-condition to “selection” for audit. Secondly, the departmental view in almost all these cases has been that order for audit is not an adverse

⁴ Parawise comments submitted by FBR in WP no. 608/2011

order, implying that it does not target a particular taxpayer but, instead, simply gauges the compliance of the tax system as a whole and as a consequence selects a taxpayer for audit on the basis of an objective criteria. Extracts from some of the important precedents support the above conclusion:

a. In *Ch. Muhammad Hussain and others v. Commissioner of Income-Tax (2005 PTD 152)* decided on 1.07.2002, the Court held:

“.....It goes without saying that non-mentioning of the basis for selection, the reasons or parameters in the impugned order, is not only an attempt to trap the unwary assessee but has also a tint of discrimination in it which is prohibited under the provisions of the constitution of this county....⁵” (*emphasis supplied*)

Mr. Muhammad Ilyas Khan, Advocate appearing on behalf of the department in this case, on the other hand, submitted that the exercise of audit causes no prejudice to the assessee.

b. In *Muneer Bhimjee and others v. Islamic Republic of Pakistan and 2 others (2005 PTD 1974)* the Division Bench of Sind High Court held:

“In our view, in case the Commissioner of Income Tax intended to initiate proceedings against the petitioners in terms of section 177 of the Income Tax Ordinance, 2001, it was necessary for him to have incorporated the relevant grounds, reasons and clauses of section 177 of the Ordinance to enable the assesses (sic) to find out the rationale/criterion and justification for selection of his case

⁵ Para 12

for audit within the scope of section 177 of the Ordinance.....⁶” (emphasis supplied)

c. In Messrs Bisma Textile Mills Ltd. through Chief Executive v. Federation of Pakistan through Secretary, Revenue Division/Chairman F.B.R. and 2 others (2009 PTD 41), august Supreme Court of Pakistan held that fresh notices be issued disclosing the criteria /reasons for the purposes of audit.

d. In Mohsin Raza v. Chairman, Federal Board of Revenue and others (2009 PTD 1507) objective criteria was held to be essential for the purposes of audit. Once again, Mr. Ilyas Khan, Advocate for the respondent department submitted that audit was not an adverse order.

e. In Messrs Sadar Anjuman-e-Ahmedia through General Attorney v. Commissioner of Income Tax (Audit Division), Faisalabad and 3 others (2010 PTD 571), this Court held:

“.....A case can always be selected for audit on the basis of criteria as laid down by the FBR besides which and in addition thereto, person can also be selected for audit by Commissioner under subsection(4) of section 177 of the Ordinance. The plain reading of subsection(4) leaves no room for any doubt that it clearly empowers the Commissioner Income Tax to issue notice on the basis of criteria spelt out in sub-clauses a, b, c and d of subsection (4) of section 177 of the Ordinance.....⁷” (emphasis supplied)

f. In Chairman FBR and others etc. v. Idrees Traders etc. [(2011) 103 Tax 131 (S.C. Pak.)] it is noted that FBR carried out a random audit when no such provision existed under section 177. Policy Letter dated 14-1-2010 proposed random

⁶ see para 7

⁷ see para 24

ballot and audit on any other basis were closed. (*emphasis supplied*)

21. The above case law is unanimous on the point that an objective criteria is a pre-condition for selection for audit. Secondly, the consistent departmental view that selection for audit is not an “adverse order” reinforces that selection for audit is a neutral function required to survey the compliance of the tax system and not an investigative tool targeting a person/taxpayer on the basis of the tax return filed by him.

22. Letter dated 14-1-2010 issued by FBR also underlines the importance of a random ballot. The said Letter states:

“2. As already decided in the Third Chief Commissioner’s Conference held on 19-12-2009... since random audit selection of cases for tax year 2008 has been held for audit of Corporate (sic) cases & cases of AOPs, the cases of audits on any other basis for tax year 2008 may be closed...⁸” (*emphasis supplied*)

23. Critical to the interpretation of section 177 is the understanding of the scope and meaning of Audit under tax laws and the distinction between default driven investigative and invasive powers, as compared to the neutral system specific audit function of the tax regulator. The Tax Audit Framework⁹ issued by the FBR in its Introduction, *inter alia*, provides :

“2. Under the current provisions of the tax laws (Income Tax Ordinance, 2001, Sales Tax Act, 1990 and Federal Excise Act

⁸ See [(2011) 103 Tax 131] page 136.

⁹ Reference: Circular (C.No.1(7)-S(T.A)/2009(Corp.) dated 11-12-2009 issued by Taxpayers Audit Wing of the FBR (which has been placed on the record as Mark A)

2005), there is a system of self assessment that enables the tax payer to determine his own tax liability. Under this system, there is major reliance on the taxpayer to file accurate and reliable tax return. The purpose of tax audit is to ensure that declarations made by the taxpayers are accurate and reliable. Main objective of the tax audit is to create deterrence for under or incorrect declarations of income by the taxpayers. **In order to ensure tax payer's confidence on this system, the selection of tax payers to be audited will be done on a random basis, using an appropriate system, that ensure objectivity in the selection process.** Such a process will also be adequately publicized and communicated to the tax payers. *(emphasis supplied)*

24. “In the modern context, it is neither desirable nor feasible to examine or inspect every single taxpayer. The revenue administration, therefore, has to rely on effective management of compliance. Promoting voluntary compliance, achieved through a self assessment system in which taxpayers comply with their tax obligations without intervention from tax officials, requires developing modern approaches to audits based on risk management. The impact of audits critically depends on a properly designed audit selection strategy...¹⁰”

Kautilya in Arthashastra, a Sanskrit work of the 4th century B.C. advocated that “We must collect taxes without upsetting the taxpayer. Just as the flower is not disturbed or hurt by the honeybee when it draws nectar, we should not disturb the taxpayer when we collect taxes.”¹¹

¹⁰ from the Foreword of “Risk Based Tax Audits- *Approaches and Country Experiences*” by Munawer Sultan Khawaja, Rajul Awasthi and Jan Loeprick -The World Bank.- 2011.

¹¹ *ibid.* p-1

25. Explaining the Role of Audit, Charles Vellutini in his essay 'Key Principles of Risk based Audits'¹² states:

“... audits promote voluntary compliance by increasing the probability of detection and penalties for non-compliant taxpayers. **This impact critically depends on a properly designed audit selection strategy** focusing on a high risk taxpayers. Similarly, audits provide a good opportunity for the tax administration to educate taxpayers on their legal obligations.... Third, audits are unique opportunities for tax administration to gather information on both the health of the tax system (by measuring the share of non-compliant taxpayers and the amount of unpaid taxes, for example) and the evasion techniques used by tax payers.” (*emphasis supplied*)

26. The new income tax law is modeled on the Universal Self Assessment Scheme. The tax return filed by a taxpayer under section 120(1)(b) of the Ordinance is taken to be an assessment order issued by the Commissioner, the day the return is furnished. The new system is based on trust and assumes that the taxpayer will disclose full particulars of his income. This procedure aims at reducing the volume of work for the tax department which is otherwise spent in scrutinizing each and every return of income and a large number of taxpayers are saved the trouble of attending to their cases at the time of scrutiny. Voluntary compliance under the self assessment system is supervised through the process of audit. Hence audit is an objective exercise with the specific purpose to assess and supervise the universal self assessment scheme at work. Selection for audit is,

¹² ibid p-15

therefore, a neutral, impartial and equitable function and is dependent on a reliable tax intelligence system. M/s. Huzaima Bukhari and Dr. Ikramul Haq, in their article “Volunatry Compliance, audit and amendments” write that “...in USA, UK, Euro zone, Scandinavia, Japan, Singapore and many other developed tax administrations the main emphasis is on selecting cases for the audit on the following basis:

1. Benchmarks are provided for each year on websites before the filing of returns. Any case falling in any of the benchmarks is automatically selected for audit. There is neither any discretion nor any discrimination involved in the audit selection process. It makes the selection process universally acceptable and transparent.”

27. It is for this reason that, in the past, section 177 specifically provided a guideline and a criteria for the Commissioner to observe before selecting a person for audit. The under-mentioned criteria remained on the statute till 27-10-2009:

- (a) The person’s history of compliance or non-compliance with this ordinance;
- (b) The amount of tax payable by the person;
- (c) The class of business conducted by the person; and
- (d) Any other matter which in the opinion of the Commissioner is material for determination of correct income.

Sub-section (d) above meant that the Commissioner could add to the list of existing criteria for carrying out selection of taxpayer for audit.

28. Another critical aspect is the comparison between invasive investigative powers of the tax regulator and the neutral non-intrusive

systemic function of audit. The Income Tax Ordinance, 2001, as stated by the departmental representative is a “paradigm shift” from the previous law and is based on voluntary compliance. Yet the Ordinance provides for specific interventional powers in case default or if anything prejudicial to the interest of the revenue is detected. The interventional investigative powers under the Ordinance are provided under sections 120, 121, 122, 174 and 176. Sections 120(3) and (4) are triggered when the return is incomplete. Section 121 allows the tax regulator to make best assessment judgment in certain cases. Amendment in the assessment can be made under section 122(5) if there is definite information against a taxpayer showing, inter alia, that income chargeable to tax has escaped assessment or under section 122(5A) if the Commissioner is of the view that the assessment order is erroneous and prejudicial to the interest of the revenue. Under section 176 the tax regulator can issue notice to obtain information or evidence from a taxpayer specified in the notice.

29. The above investigative powers are reactive and default driven, triggered by deficiency detected in the returns or records of the taxpayer during desk scrutiny of the return by the tax officer. Audit on the other hand is non-reactive and not default driven, but a neutral process to assess the performance and efficiency of the tax system. Any taxpayer identified and selected for audit in this process is because he falls in the objective selection criteria, which is designed to check the compliance and health of the tax system and for no other

reason. Therefore, audit is rooted in impartiality, neutrality and objectivity. It is for this reason that Audit has a wider scope of inquiry and engulfs the entire “tax affairs of a person or a taxpayer.” It is more expansive in scope than the investigative powers mentioned above. Additional Commissioner arguing the case for the respondent department has frankly admitted that proviso to section 177 of the Ordinance is used as an additional investigative tool because the existing investigative powers are too restrictive and hence insufficient.

30. To use the audit provision for investigation, would give the department the license to carry out a roving inquiry into the affairs of any taxpayer and fish for defaults. It is this unchartered scope of inquiry under the banner of audit that seems to have lured the tax regulators. As a result, they have used the proviso under section 177(1) to proceed against specific taxpayers by carrying out a blind roving inquiry into their tax affairs with the expectation to unearth tax violation. Perusal of the impugned notices (Schedule C) show that nothing specific has been detected or stated in the notice against the petitioners but instead only record has been called for to carry out “verification” –which clearly amounts to a sniffing expedition into the tax affairs of a person. This is not the purpose of audit. According to Huzaima Ikram and Dr. Ikramul Haq, the purpose behind any tax audit is always to check potential cases of non-compliance or tax

fraud (rather) than threatening the existing taxpayers or penalizing persons claiming refunds.¹³

31. Section 177(1) and the first proviso are also against the scheme of the Ordinance and the paradigm shift so proudly referred to by the departmental representative. The audit function has been built to create deterrence in order to buttress voluntary compliance. Its present use by the tax regulator as an investigative power to hold a fishing expedition into the tax affairs of a taxpayer impairs the concept of self-assessment and morphs it into regular assessment (as the erstwhile Income Tax Ordinance, 1979 provided). The “first proviso” is inconsistent with the spirit and mandate of the new legislation. The concept of deemed assessment order on the filing of the return by a taxpayer is brought to a naught if the tax regulator has the power to revert to regular assessment in the garb of audit and that too after the passing of the deemed assessment order under the law.

32. With this backdrop, legality of section 177 (1) and its first proviso [section 177(1)(a)] requires a revisit. First, the power to ‘select’ a person for audit by the Commissioner under section 177(1) alongwith its supporting statutory criteria under section 177(4)(a) to (d) has been removed through Finance Amendment Ordinance, 2009 w.e.f 28-10-2009 and this position has been maintained under the Finance Act, 2010. Additionally, Finance Act, 2010 exclusively empowers FBR to ‘select’ a person for audit of its income tax affairs.

¹³ *Volunatry Compliance, audits and amendments-* Huzaima Ikram and Dr. Ikramul Haq.

Second, Section 177(1) provides that “the Commissioner may call for any record or documents...for conducting audit of the person” and the proviso states that the “Commissioner may, after recording reasons in writing, call for the record or documents...of a taxpayer” to conduct audit. These provisions equip the Commissioner to call for any record from any person or taxpayer. The provisions are noticeably silent regarding parameters, guidelines or criteria which can form the basis for triggering the said provisions into motion. These skeletal provisions, lack legislative check on the exercise of power by the Commissioner, who is, therefore, free to pick and choose any person or taxpayer for audit. The requirement of giving reasons in the first proviso to section 177(1) does not remedy this inherent flaw. Infact giving “reasons” reaffirms the targeted approach of the tax regulator. Even otherwise, a quick perusal of the impugned notice provided in the schedule to this judgment shows that there are no specific reasons given but a general demand has been raised for seeking the tax record of the petitioner for “verification” clearly indicating tax regulators’ desire to hold a roving inquiry into the matter. If specific evidence were available the tax regulator could have easily invoked the investigative powers discussed above. Legislative policy of the Ordinance cannot equip the Commissioner with naked power to pick and choose according to his whims and wishes. Even though the Commissioner may be the best person in the system to identify a tax default, he cannot enjoy unguided discretion but only exercise discretion which is under a legislative guideline showing structured,

uniform and transparent exercise of discretion. Hence these provisions as they stand are *ex-facie* discriminatory and give an unchecked license to the Commissioner. Any provision of law that is *ex-facie* discriminatory also offends the right to “due process” under article 10A. Fundamental rights in our Constitution have a symbiotic relationship. They are interrelated and mutually support each other. A provision of law that is *ex facie* discriminatory and is also being applied discriminatorily cannot pass the test of due process under article 10A of the Constitution. Similarly, any such illegal and unconstitutional invasiveness to call for the record for verification is an extra burden on the taxpayer and unduly interferes with his business offending articles 18 and 23 of the Constitution. Hence section 177(1) and its first proviso offend articles 10 A, 18, 23 and 25 of the Constitution. Reliance is placed on Waris Meah v. The State etc. (PLD 1957 SC 157), Jibendra Kishore Achharyya Chowdhury and 59 others v. The Province of East Pakistan etc. (PLD 1957 SC 9), Messers East and West Steamship Company v. Pakistan etc. (PLD 1958 SC 41), Inamur Rehman v. Federation of Pakistan and others (1992 SCMR 563), Shaukat Ali Mian and another v. The Federation of Pakistan (1999 CLC 607), Government of Balochistan through Additional Chief Secretary v. Azizullah Memon and 16 others (PLD 1993 SC 341), Province of the Punjab through Secretary, Local Government and Rural Development Department, Civil Secretariat, Lahore and another v. Mian Manzoor Ahmad Wattoo (1998 CLC

1585) and *In the matter of: Reference No.2 of 2005 by the President of Pakistan (PLD 2005 SC 873)*.

33. It is also odd to note that while FBR maintains a curtain of neutrality by using random or parametric computer balloting for selection of audit, the Commissioner, without any criteria, is allowed to select a taxpayer for audit. The weight of legislative history and judicial pronouncements support an audit system based upon objective criteria. Unless legislature lays down specific power to select with a pre-fixed objective criteria, as in the past, the Commissioner has no power to select a taxpayer for audit under the present scheme of section 177.

34. At the same time section 177 (1) (except the first proviso) appears to have a specific purpose under the Ordinance. The selection for audit by FBR will be incomplete if the audit is not conducted under section 177 of the Ordinance by the Commissioner. Section 177(1) seems to work in tandem with section 214C of the Ordinance.

35. The way ahead through this legislative impasse can either be to independently judge the constitutionality of section 177(1) (excluding the proviso) and strike it down as being unconstitutional or then try to harmonize the two sets of provisions (i.e, Sections 177(1) and 214C) by using purposive interpretation of the Ordinance and using the interpretative tool of “reading down” or “recasting the statute.”

36. It is settled law that where literal construction or plain meaning causes hardship, futility, absurdity or uncertainty, the purposive or contextual construction is preferred to arrive at a more just, reasonable and sensible result. “Every law is designed to further the ends of justice and not to frustrate it on mere technicalities. Though the function of the courts is only to expound the law and not to legislate, nonetheless the legislature cannot be asked to sit to resolve the difficulties in the implementation of its intention and the spirit of the law. In such circumstances, it is the duty of the court to mould or creatively interpret the legislation by liberally interpreting the statute. The statutes must be interpreted to advance the cause of statute and not to defeat it.” Reliance is placed on Interpretation of Taxing Statutes by *Mittal*. In order to resolve the conflict between the two provisions, after the purpose of the Ordinance is clear (as is evident from the above referred provisions), is to rely on the interpretative tool of reading down. Justice Ajmal Mian J in *Elahi Cotton Mills Ltd. v. Federation of Pakistan* (PLD 1997 SC 582) held:

“That theory of reading down is a rule of interpretation which is resorted to by the courts when they find a provision read literally seems to offend a fundamental right or falls outside the competence of the particular Legislature.”

In *Indus Jute Mills Ltd. v. Federation of Pakistan* (2009 PTD 1473), Sh. Azmat Saeed J (as he then was) speaking for this Court held:

“ 37. In view of the above, this court is confronted with two possible options; either is to strike down impugned section 235 Income Tax Ordinance, 2001 being *ultra vires* the Constitution

and fundamental rights of the citizens or in the alternate, to resort to the time honoured rule of interpretation of employing the theory of reading down and looking beyond the literal meaning of the provision...”

37. Mittal in *Interpretation of Taxing Statutes* writes:

“The theory of reading down is a rule of interpretation resorted to by the Courts where a provision, read literally, seems to offend a fundamental right, or falls outside the competence of the particular legislature. In interpreting the provision of a statute the courts will presume that the legislation was intended to be *inter vires* and also reasonable. The rule followed is that the enactment is interpreted consistent with the presumption which imputes to the legislature an intention of limiting the direct operation of its enactment to the extent that is permissible. Legislature is presumed to be aware of its limitations and is also attributed an intention not to over-step its limits. To keep the act within the limit of its scope and not to disturb the existing law beyond what the object requires, it is construed as operative between certain persons, or in certain circumstances, or for certain purposes only, even though the language expresses no such circumstances of the field of operation. To sustain law by interpretation is the rule.

The reading down of a provision of a statute puts into operation the principle that so far as is reasonably possible to do so, the legislation should be construed as being within its power. It has the principal effect that where an Act is expressed in language of a generality which makes it capable, if read literally, of applying to matters beyond the relevant legislative power, the court will construe it in a more limited sense so as to keep it within power. If certain provision of law construed in one way would make them consistent with the constitution and another

interpretation would render them unconstitutional the court would lean in favour of the former construction.”

38. Dr. Avtar Singh in Introduction to Interpretation of Statues (Reprint Edition 2007) writes:-

“Similarly, for upholding any provision, if it could be saved by reading it down, it should be done, unless plain words are so clear as to be in defiance of the Constitution. These interpretations spring out because of the concern of courts to always let a legislation to achieve its objective and not to let it fall merely because of a possible ingenious interpretation. The words are not static but dynamic. This infuses fertility in the field of interpretation. The principle of reading down, however, will not be available, where the plain and literal meaning from a bare reading of any impugned provisions clearly shows that it confers arbitrary, uncanalised or unbridled power.”

39. V.R. Krishna Iyer J (as he then was) in Sunil Batra v. Delhi Administration and others [1978] 4 SCC 494 observed that “..the court does not ‘rush in’ to demolish provisions where judicial endeavour through ameliorative interpretational [sic], may achieve both constitutionality and compassionate resurrection..... Sustaining the validity of the law and softening its application was with lovely detexterity..... The semantic technique of updating the living sense of a dated legislation is, in our view, perfectly legitimate.....In the present case we are persuaded to adopt this semantic readjustment so as to obviate a logicidal sequel. A validation-oriented approach becomes the philosophy of statutory construction....” .” In Maharao Saheb Shri Bhim Singhji and others v. Union of India and others

(AIR 1981 SC 234) V.R. Krishna Iyer J once again held: “ ...reading down meanings of words with loose lexical amplitude is permissible as part of the judicial process. To sustain a law by interpretation is the rule..... Courts can and must interpret words and read their meanings so that public good is promoted and power misuse is interdicted. As Lord Denning said: ‘A judge should not be a servant of the words used. He should not be a mere mechanic in the power house of semantics’...”

40. I am, therefore, inclined to save the statute and read down Section 177(1) (except its first proviso) and interpret it to be subservient to section 214C. Therefore, while the substantive power to select a person for audit is provided in section 214C, the machinery provision providing procedure for conducting the audit is in section 177. The taxpayer will first be selected for audit under section 214C by the Federal Board of Revenue and only then would the Commissioner conduct its audit in accordance with procedure given in section 177. Reliance is also placed on Muhammad Umer Rathore v. Federation of Pakistan (PLD 2009 Lah 268), Federal Steam Navigation Co Ltd and another v. Department of Trade and Industry (1974) 2 All E R 97), Delhi Transport Corporation v. D.T.C. Mazdoor Congress and others (AIR 1991 SC 101), Sunil Batra v. Delhi Administration and others etc. (AIR 1978 SC 1675) and Jagdish Pandey v. The Chancellor, University of Bihar and others (AIR 1968 SC 353).

41. The first proviso to section 177(1) i.e., 177(1)(a) & (b) is different from Section 177(1). Unlike section 177(1), it stands excluded for the purposes of section 214C and therefore assumes an independent role of empowering the Commissioner to practically select a taxpayer for audit without any guidelines. Hence, the said first proviso equips the Commissioner with the arbitrary power to pick and choose any taxpayer for audit of its tax affairs, which as discussed above, is *ex facie* discriminatory. Second, the impugned notice shows (and as admitted by the departmental representative) the power is not being used for audit but to hold a roving inquiry into the affairs of the petitioner as an investigative tool which is also offensive to the overall scheme of self assessment and the legislative policy behind the Ordinance. The first proviso, therefore, acts to efface the legislative policy of self assessment and voluntary compliance running through the Ordinance and tries to turn back the clock of legislative history resulting in nullifying the concept of deemed assessment and reintroducing regular assessment of the erstwhile Income Tax Ordinance of 1979. The first proviso to section 177(1) of the Ordinance is, therefore, inherently discriminatory hence violative of article 25 and articles 10A, 18 and 23 of the Constitution besides being inconsistent to the scheme of the Ordinance. The first proviso to section 177(1) of the Ordinance cannot be read down, however, it can be severed from the statute in order to protect the legislative theme behind the Ordinance and to maintain the constitutionality of the remaining statute. For the above reasons, first proviso to section

177(1) of the Ordinance is struck down as being unconstitutional and illegal. With this decalaration the second proviso to section 177(1) becomes practically redundant and ineffective.

42. It is also clarified, for the sake of completion, that section 177(8) of the Ordinance will come into operation after a person has been selected for audit by the FBR under section 214C of the Ordinance.

43. For the above reasons impugned Notice datd 23-11-2011 issued by the concerned Comissioner Inland Revenue is also set aside as being unconstitutional and illegal.

Federal Excise Act, 2005 (FEA).

44. Section 46(1) of FEA provides for departmental Audit in the following manner:

“The Officer of Inland Revenue authorized by the Board or the Commissioner,by designation may, once in a year, after giving advance notice in writing, conduct audit of the records and documents of any person registered under this Act.” (*emphasis supplied*)

45. Section 42B inserted through Finance Act, 2010 states as follows:

“42B. **Selection for audit by the Board.**--- (1) The Board may select persons or classes of persons for audit of records and documents through computer ballot which may be random or parametric as the Board may deem fit.

(2) Audit of such persons selected under sub-section (1) shall be conducted as per procedure given in section 46 and all the provisions of the Act shall apply accordingly.

(3) For the removal of doubt, it is hereby declared that Board shall be deemed always to have had, the power to select any persons or classes of persons for audit.” (*emphasis supplied*)

46. Conjunctive reading of sections 42B and 46(1) of FEA shows that the power to SELECT for audit is with the FBR and the subsequent act of CONDUCTING audit is with the Officer of the Inland Revenue. Any other interpretation, especially one argued by the respondent department that the Officer of Inland Revenue can independently and simultaneously select a person for audit, for the reasons discussed above, is not tenable. All the three taxes have been harmonized and are based on the concept of self assessment encouraging voluntary compliance. The amendments vesting power in FBR to select a person for audit in the above three taxes is also identical and simultaneously introduced through Finance Act, 2010. Section 46(1) of FEA does not provide an objective criteria laying down guidelines for selection of audit. Audit cannot take place on the whims and caprice of the Officer of the Inland Revenue but on the basis of an objective criteria. The Commissioner is once again vested with uncanalized power to pick and choose and select any person for audit of its tax affairs. For the reasons discussed in detail above, section 46(1) is *ex facie* discriminatory and, therefore, unconstitutional and illegal. It is, however, clarified that the word

“audit” in section 46(2) is different from the concept of Audit in section 46(1). Audit under section 46(2) is synonymous to investigation or special audit triggered on the basis of information or sufficient evidence and the word “audit” used in the said sub-section does not carry the same meaning or neutrality as the concept of general Audit under discussion in this judgment and provided in section 46(1).

47. In the wake of the amendment brought about through section 42B in the Finance Act, 2010, constitutionality of section 46(1) is protected and the said provision saved only if it is read down or recasted to be read in tandem with section 42B. Therefore, Section 46(1) will come into play to conduct the audit once the selection for audit is made by the FBR in the manner provided under section 42B. Similarly, Chapter XIV of the Federal Excise Rule, 2005 which deals with conducting the audit will be put into motion after the selection is made under section 42B of the Act.

48. It is important to highlight that as under Income Tax Ordinance, 2001, FEA also separately provides invasive powers of investigation under section 45 read with Chapter XIII of the Federal Excise Rules, 2005. These powers are distinct from the general power to Audit as discussed above in the context of the Income Tax Ordinance, 2001.

49. For the above reasons, the impugned notice under section 46 of the Act issued by the Commissioner Inland Revenue dated 14-12-2011¹⁴ is set aside being unconstitutional and illegal.

Sales Tax Act, 1990 (“STA”).

50. Section 25(1) of STA simply provides for calling of the record by the tax regulator from a taxpayer. It is section 25(2) which provides that the officer of the inland revenue on the basis of the record obtained under sub-section (1) may, once in a year conduct audit. With the insertion of section 72B through Finance Act, 2010, FBR has been empowered to select persons for audit of tax affairs through computer balloting which may be random or parametric.

51. Section 25(2) of STA, taken independently, empowers the Commissioner to pick and choose from taxpayers whose record has been called under section 25(1). The said provision vesting the Commissioner with the power to pick and choose a taxpayer for audit, without any objective criteria, is *ex facie* discriminatory. Additionally, the scope of selection for audit is further restricted, as section 25(2) selects the taxpayers from amongst those taxpayers whose record has been earlier called under section 25(1). This alone is inconsistent with the concept of audit discussed above. Section 25(2) provides for unguided and uncanalised power to conduct audit which, for reasons given above, is *ex facie* discriminatory and hence unconstitutional and illegal.

¹⁴ In W.P. no. 11460/2012.

52. The constitutionality of section 25(1) of STA can be saved if it is read down, as discussed above, and read in tandem with section 72B of the STA. Hence, section 25(1) provides the machinery provision for conducting of audit of the tax affairs of a taxpayer, after it has been selected for audit by the FBR under section 72B.

53. It is clarified that rest of section 25, including sub-section (1) remain intact and is not dependent on section 72B. Impugned Notice dated 14-12-2011 issued under section 25 of the STA by the Commissioner Inland Revenue (Zone-11) is therefore declared to be unconstitutional and illegal and hence set aside.

54. As a conclusion, for the above reasons, Section 177(1) of the Ordinance, Section 46(1) of FEA and Section 25(2) of STA are read down and shall provide the machinery provision to conduct audit after the taxpayer is selected for audit of its tax affairs by the FBR through computer ballot which may be random or parametric.

55. For the above reasons, the impugned notices issued by the Commissioner under sections 177, 25 and 46 of the Income Tax Ordinance, 2001 Sales Tax Act, 1990 and Federal Excise Act, 2005 purportedly calling for the record of the petitioners but infact selecting the petitioners for audit of their tax affairs are declared unconstitutional, illegal and without lawful authority and therefore, set aside. Resultantly, this petition and all the petitions mentioned in Schedule A are allowed with no order as to costs.

56. Before parting with the judgment, I acknowledge with appreciation the valuable assistance rendered by the *amicus curiae*, Mr. Shabaz Butt, Advocate and the Research Assistant of the LHCRC.

(Syed Mansoor Ali Shah)
Judge

*Iqbal/M. Tahir**

APPROVED FOR REPORTING

SCHEDULE A

Sr.No.	Writ Petition No.
1.	24208/2011
2.	24209/2011
3.	24210/2011
4.	24213/2011
5.	24214/2011
6.	24215/2011
7.	24216/2011
8.	25181/2011
9.	26414/2011
10.	26415/2011
11.	26416/2011
12.	26/2012
13.	107/2012
14.	608/2012
15.	394/2012
16.	847/2012
17.	848/2012
18.	1196/2012
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(Syed Mansoor Ali Shah)
Judge

*Iqbal/M. Tahir**

SCHEDULE B

**LEGISLATIVE HISTORY OF SECTION 177
OF THE INCOME TAX ORDINANCE**

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CONTENTS OF SECTION NO. 177 WHICH REMAIN ON
STATUTE
FROM 13/09/2001 TO 30/06/2002

177. Audit.- (1) The Commissioner may select any person for an audit of the person's income tax affairs having regard to –

- (a) the person's history of compliance or non-compliance with this Ordinance;
- (b) the amount of tax payable by the person;
- (c) the class of business conducted by the person; and
- (d) any other matter that the Commissioner considers relevant.

(2) 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, particularly having regard to the factors in sub-section (1).

(3) The Central Board of Revenue may appoint a firm of Chartered Accountants as defined under the Chartered Accountants Ordinance, 1961 (X of 1961), to conduct an audit of the income tax affairs of any person and the scope of such audit shall be as determined by the Central Board of Revenue on a case by case basis.

(4) Any person employed by a firm referred to in sub-section (3) may be authorized by the Commissioner, in writing, to exercise the powers in sections 175 and 176 for the purposes of the conduct an audit under that subsection.

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CONTENTS OF SECTION NO. 177 WHICH REMAIN ON
STATUTE
FROM 01/07/2002 TO 16/06/2003

177. Audit.- (1) The Commissioner may select any person for an audit of the person's income tax affairs having regard to -

- (a) the person's history of compliance or non-compliance with this Ordinance;
 - (b) the amount of tax payable by the person;
 - (c) the class of business conducted by the person; and
 - (d) any other matter that the Commissioner considers relevant.
- (1A) After selection of a person for audit under sub-section(1), the Commissioner shall conduct an audit of the income tax affairs including examination of accounts and records, enquiry into expenditure, assets and liabilities of that person.
- (2) 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, particularly having regard to the factors in sub-section (1).
- (3) The Central Board of Revenue may appoint a firm of Chartered Accountants as defined under the Chartered Accountants Ordinance, 1961 (X of 1961), to conduct an audit of the income tax affairs of any person and the scope of such audit shall be as determined by the Central Board of Revenue on a case by case basis.
- (4) Any person employed by a firm referred to in sub-section (3) may be authorized by the Commissioner, in writing, to exercise the powers in sections 175 and 176 for the purposes of conducting an audit under that sub-section.

Note: The following amendments were made vide Finance Ordinance, 2002:

- (a) after sub-section (1), a new sub-section (1A) was inserted;
- (b) in sub-section (4), for the words "the conduct" the word "conducting" were substituted. }

**CONTENTS OF SECTION 177 WHICH REMAIN ON STATUTE
FROM 17/06/2003 TO 29/06/2004**

177. Audit.- (1) The Commissioner may select any person for an audit of the person's income tax affairs having regard to –

- (a) the person's history of compliance or non-compliance with this Ordinance;
- (b) the amount of tax payable by the person;
- (c) the class of business conducted by the person; and
- (d) any other matter that the Commissioner considers relevant.

(1A) After selection of a person for audit under sub-section (1), the Commissioner shall conduct an audit of the income tax affairs including examination of accounts and records, enquiry into expenditure, assets and liabilities of that person.

(1B) After completion of the audit under sub-section (1A) or sub-section (3), the Commissioner may, if considered necessary, after obtaining taxpayer's explanation on all the issues raised in the audit, amend the assessment under sub-section (1) or sub-section (4) of section 122, as the case may be.

(2) 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, particularly having regard to the factors in sub-section (1).

(3) The Central Board of Revenue may appoint a firm of Chartered Accountants as defined under the Chartered Accountants Ordinance, 1961 (X of 1961), to conduct an audit of the income tax affairs of any person and the scope of such audit shall be as determined by the Central Board of Revenue on a case by case basis.

(4) Any person employed by a firm referred to in sub-section (3) may be authorized by the Commissioner, in writing, to exercise the powers in sections 175 and 176 for the purposes of conducting an audit under that sub-section.

Note: After sub-section (1A), a new sub-section (1B) was inserted vide Finance Act, 2003, dated 17/06/2003.

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CONTENTS OF SECTION 177 WHICH REMAIN ON STATUTE
FROM 30/06/2004 TO 30/06/2005

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

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

(3) The Central Board of Revenue shall keep the criteria confidential.

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

- (a) the person's history of compliance or non-compliance with this Ordinance;
- (b) the amount of tax payable by the person;
- (c) the class of business conducted by the person; and
- (d) any other matter which in the opinion of Commissioner is material for determination of correct income.

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

(6) After completion of the audit under sub-section (5) or sub-section (8), the Commissioner may, if considered necessary, after obtaining taxpayer's explanation on all the issues raised in the audit, amend the assessment under sub-section (1) or sub-section (4) of section 122, as the case may be.

(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, particularly having regard to the factors in sub-section (4).

(8) The Central Board of Revenue may appoint a firm of Chartered Accountants as defined under the Chartered Accountants Ordinance, 1961 (X of 1961), to conduct an audit of the income tax affairs of any person and the scope of such audit shall be as determined by the Central Board of Revenue on a case to case basis.

(9) Any person employed by a firm referred to in sub-section (8) may be authorized by the Commissioner, in writing, to exercise the powers in sections 175 and 176 for the purposes of conducting an audit under that sub-section.

Note: This section was substituted vide Finance Act, 2004.

A/5

CONTENTS OF SECTION 177 WHICH REMAIN ON STATUTE
FROM 01/07/2005 TO 30/06/2009

177. Audit.- (1) The Central Board of Revenue, may lay down criteria for selection of any person for an audit of person's income tax affairs, by the Commissioner.
- (2) The Commissioner shall select a person for audit in accordance with the criteria laid down by the Central Board of Revenue under sub-section (1).
- (3) The Central Board of Revenue shall keep the criteria confidential.
- (4) In addition to the selection referred to in sub-section (2), the Commissioner may also select a person for an audit of the person's income tax affairs having regard to -
- (a) the person's history of compliance or non-compliance with this Ordinance;
 - (b) the amount of tax payable by the person;
 - (c) the class of business conducted by the person; and
 - (d) any other matter which in the opinion of Commissioner is material for determination of correct income.
- (5) After selection of a person for audit under sub-section (2) or (4), the Commissioner shall conduct an audit of the income tax affairs including examination of accounts and records, enquiry into expenditure, assets and liabilities of that person.
- (6) After completion of the audit under sub-section (5) or sub-section (8), the Commissioner may, if considered necessary, after obtaining taxpayer's explanation on all the issues raised in the audit, amend the assessment under sub-section (1) or sub-section (4) of section 122, as the case may be.
- (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, particularly having regard to the factors in sub-section (4).
- (8) The Central Board of Revenue may appoint a firm of Chartered Accountants as defined under the Chartered Accountants Ordinance, 1961 (X of 1961), to conduct an audit of the income tax affairs of any person and the scope of such audit shall be as

determined by the Central Board of Revenue on a case to case basis.

- (9) Any person employed by a firm referred to in sub-section (8) may be authorized by the Commissioner, in writing, to exercise the powers in sections 175 and 176 for the purposes of conducting an audit under that sub-section.

Note: The following amendments were made vide Finance Act, 2005:

- (a) for the word "after" the word "After" was substituted; and
- (b) for the word "persons", at the end, the word "person" was substituted.}

A/6

CONTENTS OF SECTION 177 WHICH REMAIN ON STATUTE
FROM 01/07/2009 TO 27/10/2009

177. Audit.- (1) The Board may lay down criteria for selection of any person or classes of persons for an audit of such person's income tax affairs, by the Commissioner.
- (2) The Commissioner shall select a person or classes of persons for audit in accordance with the criteria laid down by the Central Board of Revenue under sub-section (1).
- (3) The Central Board of Revenue shall keep the criteria confidential.
- (4) In addition to the selection referred to in sub-section (2), the Commissioner may also select a person or classes of persons for an audit of the person's income tax affairs having regard to:
- (a) the person's history of compliance or non-compliance with this Ordinance;
 - (b) the amount of tax payable by the person;
 - (c) the class of business conducted by the person; and
 - (d) any other matter which in the opinion of Commissioner is material for determination of correct income.
- (5) After selection of a person or classes of persons for audit under sub-section (2) or (4), the Commissioner shall conduct an audit of the income tax affairs including examination of accounts and records, enquiry into expenditure, assets and liabilities of such person or classes of persons.
- (6) After completion of the audit under sub-section (5) or sub-section (8), the Commissioner may, if considered necessary, after obtaining taxpayer's explanation on all the issues raised in the audit, amend the assessment under sub-section (1) or sub-section (4) of section 122, as the case may be.
- (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, particularly having regard to the factors in sub-section (4).
- (8) The Board may appoint a firm of Chartered Accountants as defined under the Chartered Accountants Ordinance, 1961 (X of 1961), to conduct an audit of the income tax affairs of any person or classes of persons selected for audit by the

Commissioner or by the Board and the scope of such audit shall be as determined by the Central Board of Revenue on a case to case basis.

- (9) Any person employed by a firm referred to in sub-section (8) may be authorized by the Commissioner, in writing, to exercise the powers in sections 175 and 176 for the purposes of conducting an audit under that sub-section.

Note: The following amendments were made vide Finance Act, 2009:

- (a) in sub-section (1):-
- (i) after the word "person" the words "or classes of persons" were inserted; and
 - (ii) after the word "of", occurring for the second time, the word "such" was inserted;
- (b) in sub-section (2), after the word "person" the words "or classes of persons" were inserted;
- (c) in sub-section (4), after the word "person" the words "or classes of persons" were inserted;
- (d) in sub-section (5),-
- (i) after the word "person" the words "or classes of persons" were inserted;
 - (ii) for the words "that person" occurring at the end, the words "such person or classes of persons" were substituted; and
- (e) in sub-section (8), after the word "person" the words "or classes of persons selected for audit by the Commissioner or by the Board" were inserted.

A/7

CONTENTS OF SECTION 177 WHICH REMAIN ON STATUTE
FROM 28/10/2009 TO 30/06/2010

177. Audit:- (1) The Commissioner may call for any record or documents including books of accounts maintained under this Ordinance or any other law for the time being in force for conducting audit of the income tax affairs of the person and where such record or documents have been kept on electronic data, the person shall allow access to the Commissioner or the officer authorized by the Commissioner for use of machine and software on which such data is kept and the Commissioner or the officer may take into possession such machine and duly attested hard copies of such information or data for the purpose of investigation and proceedings under this Ordinance in respect of such person or any other person:

Provided that the Commissioner shall not call for record or documents of the taxpayer after expiry of six years from the end of the tax year to which they relate.

(2) After obtaining the record of a person under sub-section (1) or where necessary record is not maintained, the Commissioner shall conduct an audit of the income tax affairs including examination of accounts and records, enquiry into expenditure, assets and liabilities of that person or any other person and may call for such other information and documents as he may deem appropriate.

(3)Omitted.....

(4)Omitted.....

(5)Omitted.....

(6) After completion of the audit the Commissioner may, if considered necessary, after obtaining taxpayer's explanation on all the issues raised in the audit, amend the assessment under sub-section (1) or sub-section (4) of section 122, as the case may be.

(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.

(8) The Board may appoint a firm of Chartered Accountants as defined under the Chartered Accountants Ordinance, 1961 (X of 1961), or a firm of Cost and Management Accountants as defined under the Cost and Management Accountants Act, 1966 (XIV of 1966) to conduct an audit of the income tax affairs of any person or classes of persons selected for audit by the Commissioner or by the

Board and the scope of such audit shall be as determined by the Central Board of Revenue on a case to case basis.

(9) Any person employed by a firm referred to in sub-section (8) may be authorized by the Commissioner, in writing, to exercise the powers in sections 175 and 176 for the purposes of conducting an audit under that sub-section.

(10) Notwithstanding anything contained in sub-sections (2) and (6) where a person fails to produce before the Commissioner or a firm of Chartered Accountants or a firm of Cost and Management Accountants appointed by the Board under sub-section (8) to conduct an audit, any accounts, documents and records, required to be maintained under section 174 or any other relevant document, electronically kept record, electronic machine or any other evidence that may be required by the Commissioner or the firm of Chartered Accountants or the firm of Cost and Management Accountants for the purpose of audit or determination of income and tax due thereon, the Commissioner may proceed to make best judgment assessment under section 121 of this Ordinance and the assessment treated to have been made on the basis of return or revised return filed by the taxpayer shall be of no legal effect.

Note: The following amendments were made vide Finance (Amendment) Ordinance, 2009 and Finance (Amendment) Ordinance, 2010:

- (a) sub-section (1) was substituted;
- (b) sub-section (2) was substituted;
- (c) sub-section (3), (4) and (5) were omitted;
- (d) in sub-section (6), the words, brackets and figures ``under sub-section (5) or sub-section (8)" were omitted;
- (e) in sub-section (7), the word, brackets and figure ``where there are reasonable grounds for such audits, particularly having regard to the factors in sub-section (4)" were omitted;
- (f) in sub-section (8), after the brackets letter, word, figure and commas (X of 1961)", the words, figures and brackets "or a firm of Cost and Management Accountants as defined under the Cost and Management Accountants Act, 1966 (XIV of 1966)" were inserted; and
- (g) after sub-section (9), a new sub-section (10) was added.

A/8

**CONTENTS OF SECTION 177 WHICH REMAIN ON STATUTE
FROM 01/07/2010 TO TILL TODATE**

177. Audit.- (1) The Commissioner may call for any record or documents including books of accounts maintained under this Ordinance or any other law for the time being in force for conducting audit of the income tax affairs of the person and where such record or documents have been kept on electronic data, the person shall allow access to the Commissioner or the officer authorized by the Commissioner for use of machine and software on which such data is kept and the Commissioner or the officer may have access to the required information and data and duly attested hard copies of such information or data for the purpose of investigation and proceedings under this Ordinance in respect of such person or any other person: Provided that—

- (a) the Commissioner may, after recording reasons in writing call for record or documents including books of accounts of the taxpayer; and
- (b) the reasons shall be communicated to the taxpayer while calling record or documents including books of accounts of the taxpayer:

Provided further that the Commissioner shall not call for record or documents of the taxpayer after expiry of six years from the end of the tax year to which they relate.

(2) After obtaining the record of a person under sub-section (1) or where necessary record is not maintained, the Commissioner shall conduct an audit of the income tax affairs including examination of accounts and records, enquiry into expenditure, assets and liabilities of that person or any other person and may call for such other information and documents as he may deem appropriate.

(3)Omitted.....

(4)Omitted.....

(5)Omitted.....

(6) After completion of the audit the Commissioner may, if considered necessary, after obtaining taxpayer's explanation on all the issues raised in the audit, amend the assessment under sub-section (1) or sub-section (4) of section 122, as the case may be.

(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.

(8) The Board or the Commissioner may appoint a firm of Chartered Accountants as defined under the Chartered Accountants Ordinance, 1961 (X of 1961) or a firm of Cost and Management Accountants as defined under the Cost and Management Accountants Act, 1966 (XIV of 1966), to conduct an audit of the income tax affairs of any person or classes of persons and the scope of such audit shall be as determined by the Board or the Commissioner on a case to case basis.

(9) Any person employed by a firm referred to in sub-section (8) may be authorized by the Commissioner, in writing, to exercise the powers in sections 175 and 176 for the purposes of conducting an audit under that sub-section.

(10) Notwithstanding anything contained in sub-sections (2) and (6) where a person fails to produce before the Commissioner or a firm of Chartered Accountants or a firm of Cost and Management Accountants appointed by the Board or the Commissioner under sub-section (8) to conduct an audit, any accounts, documents and records, required to be maintained under section 174 or any other relevant document, electronically kept record, electronic machine or any other evidence that may be required by the Commissioner or the firm of Chartered Accountants or the firm of Cost and Management Accountants for the purpose of audit or determination of income and tax due thereon, the Commissioner may proceed to make best judgment assessment under section 121 of this Ordinance and the assessment treated to have been made on the basis of return or revised return filed by the taxpayer shall be of no legal effect.

Note: The following amendments were made vide Finance Act 2010:

- (a) sub-section (1) was substituted;
- (b) sub-section (2) was substituted;
- (c) sub-section (3), (4) and (5) were omitted;
- (d) in sub-section (6), the words, brackets and figures "under sub-section (5) or sub-section (8)" were omitted;
- (e) in sub-section (7), the words, comma, brackets and figure "particularly having regard to the factors in sub-section (4)" were omitted;
- (f) in sub-section (8),
 - (i) the words, "selected for audit by the Commissioner or by the Board" were omitted;
 - (ii) after the word, "Board" occurring twice the words, "or the Commissioner" were added; and
 - (iii) after the brackets letter, word, figure and commas (X of 1961)", the words, figures and brackets "or a firm of Cost and Management Accountants as defined under the Cost and Management Accountants Act, 1966 (XIV of 1966)" were inserted; and
- (g) after sub-section (9), a new sub-section (10) was added.

(Syed Mansoor Ali Shah)
Judge

*Iqbal/M. Tahir**

SCHEDULE C

No.CIR/ZONE-I/RTO/FSD/987

Dated 23.11.2011.

The Principal Officer
M/s. Chenone Stores Limited,
Nishatabad, Faisalabad.

Subject; **AUDIT U/S 177 OF THE INCOME TAX
ORDINANCE, 2001 FOR THE TAX YEAR
2010-**

Dear Taxpayer,

It is to inform you that in accordance with the provisions of Section 177 (1) of the Income Tax Ordinance, 2001, you are required to please produce all records i.e. vouchers, payment receipts, cash memos etc. including books of accounts i.e. cash book/ledger etc. maintained by you for the tax year 2010, as your case is to be audited u/s 177 (1) for the tax year 2010.

2. The reasons for conducting the audit for this year are as follows:

- i. To verify the nature/quantum of sales/purchase, manufacturing and other direct expenses declared for the year.
- ii. Trade creditors shown at Rs.548980811/- as on 30.06.2010, needs verification in terms of section 39 (3) of the I.T. Ordinance, 2001.
- iii. The Imports Rs.47825542/- as per Customs data are appearing in Sales Tax at Rs.3140852/- whereas the same have been declared in Income Tax at Rs.234741028/- which needs verification and reconciliation through Audit.
- iv. The addition in depreciable assets at Rs.170337321/- as well as tax depreciation claimed needs verification.

- v. The advances from customers shown at Rs.11858187/- needs verification.
- iv. Profit & loss account expenses claimed at Rs.402630347/- inclusive of financial expenses at Rs.77169247/- needs verification and its admissibility as per section 174, 21 and 22 of the I.T. Ordinance, 2001.

3. In view of the above reasons, it has become imperative that the above issues may be examined in depth through Audit to eliminate any possible risks to the provisions of section 177 of the Income Tax Ordinance, 2001. The books of accounts complete in all respects shall be produced by or before 15-12-2011 to DCIR Audit Unit-01, Zone-I, Regional Tax Office, Faisalabad.

4. It is assured that the audit proceedings would be closed if nothing adverse is discovered. I hope that you will fully cooperate with the department during the audit proceedings.

Sd/-
(SHAFQAT MEHMUD)
Commissioner

Ref. No.LTU/Audit-02/11

Dated 14.12.2011.

M/s Jamshoro Joint Venture Limited,
7-Egerton Road, Lahore.

Subject: **AUDIT U/S 25 OF THE SALES TAX ACT, 1990
AND SECTION 46 OF THE FEDERAL EXCISE
ACT, 2005.**

Dear Registered Person,

It is hereby intimated that your Sales Tax as well as Federal Excise (if applicable) audit is decided to be conducted for the period July 2009 to June 2010.

2. You are requested to make available the under mentioned records/documents under section 25 of the Sales Tax Act, 1990 and section 46 of the Federal Excise Act, 2005 within Seven days of the receipt of this letter;

- a) Record of purchases from registered and non-registered persons
 - b) Records of Sales to registered and non-registered persons
 - c) Inventory and stock records
 - d) Month wise production statement.
 - e) Purchase Invoices/Bills of Entry
 - f) Supply Invoices/Bills of Export
 - g) Payment proofs and bank statements.
 - h) Annual Accounts/Financial records.
 - i) Any other information, if required.
- 3.....

sd/-

(RUKHSANA YASMIN)

Commisioner Inland Revenue (Zone-II)

(Syed Mansoor Ali Shah)
Judge

*Iqbal/M. Tahir**