ORDER SHEET
IN THE ISLAMABAD HIGH COURT, ISLAMABAD
JUDICIAL DEPARTMENT

Writ Petition No. 35 of 2022

Fairdeal Exchange Company (Private) Limited
versus
FOP through Ministry of Finance and others

Petitioner by: Mr. Faisal Rasheed Ghouri, Advocate

Respondents by: Barrister Atif Rahim Barki, Advocate for respondents no.2 to 4.
Ch. Tahir Mehmood, A.A.G.

Date of Hearing: 12.12.2022

Writ Petition No. 136 of 2022

Pakistan Television Corporation Limited
versus
Commissioner Inland Revenue (Audit-I) and others

Petitioner by: Hafiz Muhammad Idris, Advocate

Respondents by: Mr. Babar Bilal, Advocate for respondents no.1 to 3
Ch. Muhammad Tahir Mehmood, A.A.G assisted by Masood Akhtar, Commissioner IR Audit LTU and Muhammad Faheem, Deputy Commissioner, IR Unit, LTU, Islamabad.

Date of Decision: 10.05.2022

Sardar Ejaz Ishaq Khan, J: The two writ petitions 136 and 35 of 2022 decided by this judgement raise common questions.

W.P. no. 136 of 2022

2 Pakistan Television Corporation Limited (PTV) is aggrieved of its selection for audit vide notice dated 17.12.2021 issued under section 177(1) of the Income Tax Ordinance, 2001 (ITO) issued by respondent no.1, followed by notice dated 04.01.2022 issued by respondent no.2 to produce the record for audit.

3 PTV says that the law requires a 'two-step' process for audit whereby, between the 1st and the 2nd notices, an intermediate hearing was to

be held by the Commissioner Inland Revenue with PTV endeavouring to satisfy the Commissioner Inland Revenue (CIR) on the reservations which caused her to issue the 1st notice, which was then to be followed by a speaking order justifying the audit, and only then the 2nd notice could be issued. PTV's second contention is that the CIR's jurisdiction under § 171(1)[1] was either abolished under section 214C by implication or, in the alternative, was subservient to the Board's power for selection of audit under § 214 C. Mr. Idris appearing for PTV cited the judgments in *PTCL*[2], *Kohinoor*[3], and *ChenOne*[4] cases.

4 Mr. Bilal appearing for the FBR opposed PTV's stance, placing his reliance primarily on the *Pak Tobacco*[5] case.

W.P. no. 35 of 2022

5 Fairdeal is aggrieved for the same reasons as PTV is, albeit its grievance is five-fold, for it received 5 audit selection notices under § 171(1) issued by respondent no.3 for 5 tax years 2016 to 2020, followed immediately with 5 notices by respondent no.4, the Assistant Commissioner Inland Revenue (ACIR), to produce the records for audit.

6 Mr. Ghouri appearing for Fairdeal had 3 primary contentions. The first two were the same as PTV's. The 3rd is that § 177(7), in its spirit if not in letter, precludes simultaneous audit for multiple years. He read passages from PTCL, Kohinoor, and ChenOne in support of his submission that, between the communication of the reasons in an audit-selection notice under §177(1) and production of the entire record for the audit, there has to

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[1] All references to sections are to the sections of the ITO, unless otherwise stated.

[2] *Pakistan Telecommunication Company Limited versus Federation of Pakistan* (2016 PTD 1484), a full bench judgment of the Islamabad High Court.

[3] *Kohinoor Sugar Mills versus Federation of Pakistan and others* (2018 PTD 821), a single bench judgment of the Lahore High Court.

[4] *The Federal Board of Revenue and others versus Messrs Chenone Store Ltd.* (2018 PTD 208)

[5] *Pakistan Tobacco Company Limited versus Federation of Pakistan and others* (WP 272/2021), a single bench judgment of the Islamabad High Court.

be an interim step of affording an opportunity of hearing to the taxpayer followed by a speaking order and only thereafter the audit may be proceeded with. He submitted, referring to Fairdeal's tax advisers' replies[6] on record to the audit-selection notices that, although respondent no.3 CIR had provided an opportunity of hearing, he had not yet passed a speaking order to proceed with the audit when respondent no.4 ACIR nonetheless issued the 2nd set of notices summoning Fairdeal's financial records; it is this 2nd set of notices that Fairdeal is primarily aggrieved of.

7 For his 3rd contention, Mr. Ghouri says that simultaneous audit of 5 years running is against the spirit, if not the letter, of § 177(7), which speaks of an audit for a single year, and that to interpret § 177(7) otherwise would render the clarification therein meaningless. Mr. Ghouri referred to FBR's circular no. C.4(36)ITP/ 2002 dated 05.10.2009 (**2009 circular**) for his submission that FBR did not permit the selection of cases for audit for multiple years, and urged that this circular, reproduced below in material part, supports the interpretation he asks this Court to place on §177(7):

> " …
> **Selection of Cases for Audit for Current Year as well as for the Previous Years i.e. Multiple Audit.**
>
> … Cases for audit are required to be selected under section 177, on the basis of given parameters. Income Tax law also provides for amendment of an assessment, if warranted by the facts of the case. Therefore, there is no justification to select a case for audit for multiple tax years (current year as well as the previous years), as this practice causes undue harassment to the taxpayers.
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> …A case shall be selected for audit for the current year only and *discrepancy, if any, noticed in the previous year's declarations the same shall be addressed by amendment of the relevant assessment*.
>
> …Needless to remind that the taxpayers facilitation being the focal aim of the ongoing reform process, any practice denting the taxpayer's

[6] A review of these replies does tend to fortify the 'harassment' complaint of the taxpayer, of which more discussion will be found later in this judgment. Respondent no.4 ACIR gave only a week or so to Fairdeal to produce its entire financial records of the past 5 years.

> confidence must be avoided through the prudent application of the provisions of income tax law."
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> (emphasis supplied)

8 Mr. Burki appearing for FBR and the FBR's representative protested that the 2009 circular was no longer in force, but did not produce, despite a few intervening hearings, any later circular withdrawing the 2009 circular. I therefore take it that the 2009 circular still constitutes instructions of the FBR to its team, and Mr. Ghouri urges that team members falling out of line weaken the tax reform process. He has a point.

9 Responding to FBR's argument that these petitions were not maintainable as selection for audit was not an adverse action, Mr. Ghouri emphatically states to the contrary that audit selection for 5 years simultaneously without the two-step process is indeed adverse action. I deal with this point with a brief answer for now that the reasons given by the CIR in the notice for audit-selection remain justiciable in judicial review given the absence of an alternate remedy.

The Court's opinion

10 The two contentions, namely, (i) the two-step process for audit, and (ii) the subordination of §177(1) audit selection regime to the §214C regime, are already settled by a quartet of binding or persuasive precedent, comprising *PTCL*, *Kohinoor*, *ChenOne* and *Pak Tobacco* cases. I find no purpose to restating in my words the reasons for that precedent. The judgements, detailed and researched, trace the history of selection for audit, the evolution of the law on the subject, the policy arguments of curtailing unfettered and unstructured exercise of discretion, *audi alteram partem*, and others. All reached the same conclusions of law. The nuances of reasoning are conditioned by the facts of those cases, and do not detract from the common threads of agreement on the conclusions of law. Learned counsels for the petitioners' submissions resting on isolated readings of certain paragraphs of those judgements in the context of the two-step process is a topic to which I will return later in more detail.

11 So I endeavour to summarise the legal principles that I take to be settled by the quartet, which answer the corresponding submissions by counsel:

i) selection for audit under section 177(1) by the CIR is not contingent on selection for audit by the Board[7] under § 214 C;

ii) this is the position regardless of the creeping erosion of the *deemed assessment* status of a tax return under § 120;

iii) an audit may or may not lead to an amended assessment; an audit report is subject to *audi alteram partem*, and is to be issued only *after obtaining taxpayers explanation*;[8]

iv) yet another opportunity of hearing[9] is afforded before amending the assessment following the hearing on the audit report;

v) an audit selection notice under § 177(1) must list reasons for selection, and the reasons must be communicated to the taxpayer;

vi) if the reasons given for selection are manifestly inadequate[10], the notices will be set aside or remanded for the revenue to give proper reasons after hearing the taxpayer; and

vii) the law does not invariably require a 'two-step' progression to audit: where proper reasons are given in the audit-selection notice, the audit can proceed without an intermediate hearing and a speaking order by the Commissioner – in other words, a 'preliminary' audit is not required[11].

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[7] on a parametric basis or otherwise.

[8] Section 177(6)

[9] Section 122(9)

[10] "… reasonable basis for issuing a notice for selecting a taxpayer for audit would always be something more than mere suspicion and something less than definite information… " Pak Tobacco, paragraph 13.

[11] "…the statute does not conceive of an adjudicatory stage prior to initiation of an audit and where an opportunity is to be provided it is specifically mentioned under sections 122(9) as well as 177 (6) of

12 The stage is now set to discuss the 'two-step' argument in some detail, for it was voiced at some length at the bar, with Mr. Ghouri reading paragraph 34 of *Kohinoor*, which unequivocally speaks of a hearing and a speaking order by the CIR before proceeding with the audit. However, paragraph 34 is not to be read in isolation but with paragraphs 40 and 41[12], which record that the Hon'ble Judge found that some impugned notices did not disclose the reasons on the basis of which the records of taxpayers had been summoned. Paragraph 34 cannot be read to lay down a principle divorced altogether from the ratio of the judgement, which concluded by a direction to the CIR for a hearing and speaking order where the notices did not disclose reasons for calling the record. That is why the Court found it necessary to send the taxpayer back to the CIR and for the CIR to ensure a reasoned order before he proceeded with the audit. *Kohinoor* cannot therefore be read to lay down an absolute rule of a two-step process.

13 Which brings me to conclude that, where the audit-selection order issued under §171(1) is a well-reasoned one, there will not be a 2nd step of a hearing and a speaking order by the CIR. Compelling the CIR for yet another order would not only bewilder the CIR as to what more she needs to say to justify the audit selection, it would also sound rather silly to say to the CIR that, although you have given reasons which read well, you need to give more.

14 The other cases in the quartet are no different. The full bench's directions in *PTCL* to the CIR to hear the taxpayers and pass speaking orders before proceeding with the audit came on the heels of the finding that the reasons given in the audit selection notices were materially

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the Ordinance…" Pak Tobacco, para 12.

[12] "…however, *in cases where notices do not disclose reasons* for calling the record, I direct the concerned commissioners, before proceeding further, to disclose and communicate reasons to the taxpayers in writing, provide them an opportunity of hearing, decide the objections to recent orders and thereafter proceed further (if necessary) justly, fairly and strictly in accordance with law."

deficient. The full bench examined the notices and observed at paragraph 32:

> "We are afraid that in most of the cases the reasons do not meet the standard of reasons envisaged in subsection 1 of section 177. Neither do the reasons recorded disclose a criterion noting that the selection of individual cases had been made on reasonable grounds…."

15 Though not an actionable injury[13], the "*possible deleterious effect of audit on a business*"[14], and the absence of any *ex-ante* audit criteria, are concerns that have engaged the Courts at all times. Leaving the door open for judicial review and enforcing the statutory obligation to communicate reasons to the taxpayer have been the judicial safeguards[15] against that deleterious effect. The safeguard would be easily penetrable if it were to stop at the threshold of reasons, while leaving the audit at large to venture into areas beyond the ones captured in the given reasons so as to make the audit a roving enquiry into other tax affairs which do not appear in the reasons stated in the audit-selection order. To illustrate, a discrepancy between withholding tax deducted for salary stated in the tax return versus the periodic withholding statements given as the reason for audit selection ought to remain confined to summoning the record related to withholding taxes and salary alone, and ought not form the basis for a general and expansive audit into other financial records such as those relating to capital expenditure or investments, for that would become a roving enquiry beyond the scope of the reasons, which is forbidden territory. The reasons given in the audit-selection order dictate and circumscribe the extent of the records that ought to be summoned and audited, and the record summoned for audit

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[13] *Commissioner of Inland Revenue, Sialkot versus Allah Din steel and rolling mills* (2018 SCMR 1328), cited at para 9 of Pak Tobacco.

[14] Pak Tobacco, para 22, citing Allah Din para 18.

[15] "…statutory framework of audit coupled with the overarching umbrella of constitutional guarantees furnishes adequate and sufficient safeguards to the taxpayer; hence, the lawful exercise of the power to conduct an audit cannot be denied: *CellandGene Pharma vs FOP* (2022 PTD 1464), citing Allah Din. Also, "…the Ordinance of 2001 does not provide a statutory remedy against the taxpayers' illegal selection for audit." Pak Tobacco, para 28.

has to correlate with the reasons given for the audit. Asking to produce the entire plethora of financial records, some or a fair bit of which is not relevant to the discrepancies noted in the reasons for the audit-selection, may well amount to a roving enquiry that obliterates the safeguard of listing and communication of the reasons for audit to the taxpayer.

16 I detour here briefly to deal with the FBR's reliance on a part of its *Income Tax Audit Handbook, Income Tax Manual, Part V*, which deals with the selection for audit. Chapter III, para 3.1, speaks of a desk-audit, with a 'pre-audit' analysis, looking for signals calling for audit, that include ratio-analysis showing deviations from industry benchmarks, net worth audits with capital injections and withdrawals, international transactions, and the like. But these are 'cues' for audit-selection, and not the 'criteria' for audit-selection that the full bench speaks of in *PTCL*. Should a ratio be out of industry benchmarks by 10% to be selected for audit or only by 1%? It is the absence of *ex-ante* criteria that creates room for the proverbial taxpayers' harassment and, until such criteria are in force, the statutory duty under the proviso to § 177(1), coupled with a robust enforcement of this duty, provides the safety net for the taxpayer.

The impugned notices

17 I now turn to examine whether the impugned audit-selection orders were supported with proper reasons. It is a valid question as to what should be the extent of detail in the reasons for them to meet the 'standard required under § 171(1)'[16]. It is impossible to lay down a standard test. The answer, as is the case in almost all similar situations, is that the reasons should reflect an objective application of mind with reference to the specific heads that appear discrepant, and once that threshold is crossed, the reasons would meet 'the standard required'. I respectfully agree with *Pak Tobacco* that

[16] Paragraph 32, PTCL.

the judicial scrutiny of the reasons will not be to exacting standards[17], and I add that it would be in the nature of a '*prima facie*' examination.

18 The impugned notice to PTV identifies discrepancies between the salary expense and withholding taxes deducted on salaries, incorrect proration of expenses, unexplained cash expenses, and several others, with the discrepant numbers given where available. I find these reasons meet the required standard.

19 The impugned audit-selection notices, the 1st set of notices, to Fairdeal identified discrepancies under 7 heads[18]:

i) salary expense
ii) exchange income; commission income on remittances
iii) withholding tax credit
iv) issuance of shares
v) creditors, accrued and other liabilities,
vi) addition to fixed assets, and
vii) directors' remuneration.

The impugned notices list the discrepant numbers under each head with adequate detail, and make sense even to a person not steeped in tax jargon that the discrepancies beg investigation. So I find that the reasons in the impugned notices meet the required standard, and obviate the need for sending the matter back to the CIR.

20 No arguments were addressed whether the extent of record called for spills beyond the scope of the reasons given in the impugned audit-selection notices and, as discussed in paragraph 15 above, read with the 2009 circular, an unlimited audit spilling beyond the scope delineated by the

[17] Para 13, Pak Tobacco.

[18] as summarized by Fairdeal's advisers' reply to the ACIR.

reasons in the impugned notices will be unwarranted. It needs clarifying that this restraint does not preclude the power under § 177(2) for the CIR to ask for further information, as long as such information is relevant, is called with reason, and does not amount to a roving inquiry.

21 That brings us now to the validity of simultaneous multiple year tax audit. The FBR didn't give a satisfactory answer when asked why the 2009 circular should not be observed by the CIR. I am at a loss to understand why FBR's representative in Court defends the CIR's defiance of the 2009 circular. All the more so when the revenue, on an audit for any year, per the 2009 circular, is not left without recourse and can take the proceedings for amendment of assessment for other years. No basis was shown by the FBR as to why did the 2009 circular not qualify as 'instructions' by the Board to be 'observed' by the CIR under § 214, when the 2009 circular in the final para calls for the 'instructions' therein to be circulated 'for compliance'.

The Decision

22 WP 136 of 2022 is **dismissed**, but with the observations in paragraph 24.

23 WP 35 is **partly allowed**. The CIR may select any one of the years for which the impugned notices for audit were issued, and the impugned notices for the other years will stand cancelled upon such selection.

24 In either case, the records called for the audit are to correspond to the reasons given in the audit-selection notices.

(Sardar Ejaz Ishaq Khan)
Judge

Announced in the open Court on 27.01.2023.

Judge

Approved for reporting.

Rana. M. Ift