

Audit and assessment u/s 177/122 of the Income Tax Ordinance 2001

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Audits

The Taxman Cometh: Keep Your Head (and Revenues) Down

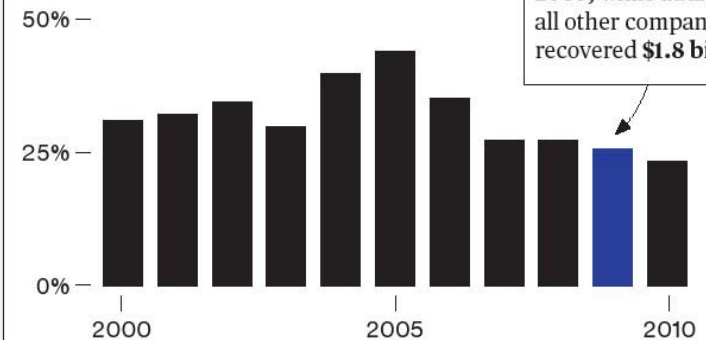
The majority of IRS business audits hit small companies because they far outnumber big ones. Large corporations and wealthy individuals, though, stand a much greater chance of being audited. —*John Tozzi*

Chances of being audited

Probability		Audits (FY 2010)
14.2%	Corporations with assets over \$10m	10,207
8.4%	Individuals earning over \$1m	32,494
2.7%	Individuals earning \$200,000–\$1m	120,481
1.1%	All individuals	1,581,394
1.0%	Individuals earning under \$200,000	1,428,419
0.9%	Corporations with assets under \$10m	19,127
0.6%	All businesses	58,067
0.4%	S corporations and partnerships	28,733

Sole proprietors of small businesses have an audit rate of 2.6%

Percent of large corporations* audited

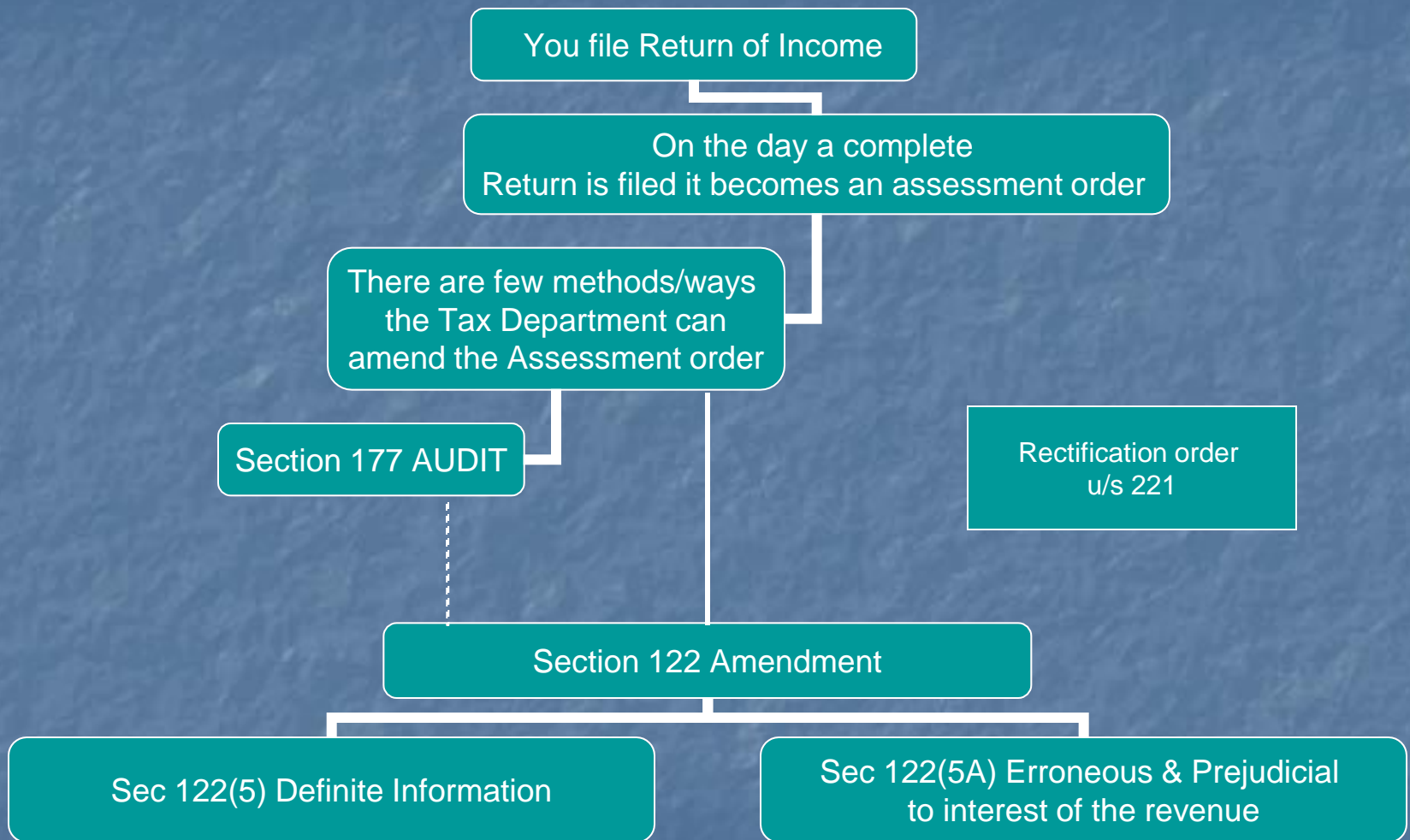


It makes sense for the IRS to go after the big guys; audits of large companies recovered **\$28.6 billion** in 2009, while audits of all other companies recovered **\$1.8 billion**

Money recovered per hour spent auditing



DATA: IRS, TRANSACTIONAL RECORDS ACCESS CLEARINGHOUSE REPORTS *ASSETS OVER \$250M



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Section 122

122. Amendment of assessments.-

- (1) Subject to this section, the Commissioner may amend an assessment order treated as issued under section 120 or issued under section 121 [or issued under section 59, 59A, 62, 63 or 65 of the repealed Ordinance, by making such alteration or additions as the Commissioner considers necessary .
- (2) No order under sub-section (1) shall be amended by the Commissioner after the expiry of five years from the end of the financial year in which the Commissioner has issued or treated to have issued the assessment order to the taxpayer.
- (3) Where a taxpayer furnishes a revised return under sub-section (6) or (6A) of section 114-
 - (a) the Commissioner shall be treated as having made an amended assessment of the taxable income and tax payable thereon as set out in the revised return; and
 - (b) the taxpayer's revised return shall be taken for all purposes of this Ordinance to be an amended assessment order issued to the taxpayer by the Commissioner on the day on which the revised return was furnished.

Section 122

(4) Where an assessment order (hereinafter referred to as the "original assessment") has been amended under sub-section (1) [,] (3) [or (5A)], the Commissioner may further amend [, as many times as may be necessary,] the original assessment within the later of-

or (a) Five years [from the end of the financial year in which] the Commissioner has issued
is treated as having issued the original assessment order to the taxpayer; or

(b) one year [from the end of the financial year in which] the Commissioner has issued or
is treated as having issued the amended assessment order to the taxpayer.

in section 65 of the aforesaid Ordinance in respect of an assessment order passed under that section and the time-limit specified in that section shall apply accordingly.

(5) An assessment order in respect of a tax year, or an assessment year, shall only be amended under sub-section (1) and an amended assessment for that year shall only be further amended under sub-section (4) where, on the basis of definite information acquired from an audit or otherwise, the Commissioner is satisfied that-

(i) any income chargeable to tax has escaped assessment; or

(ii) total income has been under-assessed, or assessed at too low a rate, or has been the subject of excessive relief or refund; or

(iii) any amount under a head of income has been mis-classified.

Section 122

- (5A) Subject to sub-section (9), the Commissioner may amend, or further amend, an assessment order, if he considers that the assessment order is erroneous in so far it is prejudicial to the interest of revenue.
- (5AA) In respect of any subject matter which was not in dispute in an appeal the Commissioner shall have and shall be deemed always to have had the powers to amend or further amend an assessment order under sub-section (5A).
- (5B) Any amended assessment order under sub-section (5A) may be passed within the time-limit specified in sub-section (2) or sub-section (4), as the case may be.
- (6) As soon as possible after making an amended assessment under sub-sections (1), sub-section (4) or sub-section (5A), the Commissioner shall issue an amended assessment order to the taxpayer stating-
 - (a) the amended taxable income of the taxpayer;
 - (b) the amended amount of tax due;
 - (c) the amount of tax paid, if any; and
 - (d) the time, place, and manner of appealing the amended assessment.

Section 122

- (7) An amended assessment order shall be treated in all respects as an assessment order for the purposes of this Ordinance, other than for the purposes of sub-section (1).
- (8) For the purposes of this section, “definite information” includes information on sales or purchases of any goods made by the taxpayer [receipts of the taxpayer from services rendered or any other receipts that may be chargeable to tax under this Ordinance,] and on the acquisition, possession or disposal of any money, asset, valuable article or investment made or expenditure incurred by the taxpayer.
- (9) No assessment shall be amended, or further amended, under this section unless the taxpayer has been provided with an opportunity of being heard.]

Section 176

176. Notice to obtain information or evidence.-

- (1) The Commissioner may, by notice in writing, require any person, whether or not liable for tax under this Ordinance-
 - (a) to furnish to the Commissioner or an authorised officer, any information relevant to any tax [leviable] under this Ordinance as specified in the notice; or
 - (b) to attend at the time and place designated in the notice for the purpose of being examined on oath by the Commissioner or an authorised officer concerning the tax affairs of that person or any other person and, for that purpose, the Commissioner or authorised officer may require the person examined to produce any accounts, documents, or computer-stored information in the control of the person [;or]
 - (c) the firm of chartered accountants, as appointed by the [Board or the Commissioner], to conduct audit under section 177, for any tax year, may with the prior approval of the Commissioner concerned, enter the business premises of a taxpayer, selected for audit, to obtain any information, required production of any record, on which the required information is stored and examine it within such premises; and such firm may if specifically delegated by the Commissioner, also exercise the powers as provided in sub-section (4).]

Section 176

- (2) The Commissioner may impound any accounts or documents produced under sub-section (1) and retain them for so long as may be necessary for examination or for the purposes of prosecution.
- (3) [The person from whom information is required, may at his option, furnish the same electronically in any computer readable media.] Where a hard copy or computer disk of information stored on a computer is not made available as required under sub-section (1), the Commissioner may require production of the computer on which the information is stored, and impound and retain the computer for as long as is necessary to copy the information required.
- (4) For the purposes of this section, the Commissioner shall have the same powers as are vested in a Court under the Code of Civil Procedure, 1908 (Act V of 1908), in respect of the following matters, namely:-
 - (a) enforcing the attendance of any person and examining the person on oath or affirmation;
 - (b) compelling the production of any accounts, records computer-stored information, or computer;
 - (c) receiving evidence on affidavit; or
 - (d) issuing commissions for the examination of witnesses.
- (5) This section shall have effect notwithstanding any rule of law relating to privilege or the public interest in relation to the production of accounts, documents, or computer-stored information or the giving of information.

Section 177

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 authorised 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.]

Section 177

- (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 authorised 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.]

Section 177

(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 documents, 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.

Section 214C

214C. Selection for audit by the Board,-

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

Section 122(5A) of I.T.Ordinance 2001

[(5A) Subject to sub-section (9), the Commissioner may amend, or further amend, an assessment order, if he considers that the assessment order is erroneous in so far it is prejudicial to the interest of revenue.

Section 66A of I.T.Ordinance 1979(R)

[66A. Powers of Inspecting Additional Commissioner to revise Deputy Commissioner's order.- (1) The Inspecting Additional Commissioner may call for and examine the record of any proceedings under this Ordinance, and if he considers that any order passed therein by the Deputy Commissioner is erroneous in so far as it passed therein by the Deputy Commissioner is erroneous in so far as it is prejudicial to the interests of revenue, he may, after giving the assessee an opportunity of being heard and after making, or causing to be made, such enquiry as he deems necessary, pass such order thereon as the circumstances of the case justify, including an order enhancing or modifying the assessment, or canceling the assessment and directing a fresh assessment to be made.

- to exercise valid jurisdiction u/s 122(5A) of Income Tax Ordinance 2001, twin conditions have to be simultaneously present.
- The order sought to be revised should be erroneous
- The order sought to be revised should simultaneously be prejudicial to the interest of the revenue.
- Unless both conditions are simultaneously present, the officer cannot assume jurisdiction u/s 122(5A) of Income Tax Ordinance 2001
- it is now a well settled law that revisional jurisdiction such as under section 122(5A) of Income Tax Ordinance 2001 cannot be exercised on mere assumptions or suppositions or fanciful assumptions (**2004 PTD 422, 2005 PTD 344, 2004 PTD 2494**)
- the courts have held that fact finding, fishing inquiry or document seeking is beyond the scope and jurisdiction of section 122(5A) of Income Tax Ordinance 2001. (**2008 PTD 1491, 2010 PTD 111**).

Let us talk about some questions that must be playing up:

- 1) Can a tax payer who only has income which is covered under presumptive tax regime be selected for Audit?

Yes. Hon. Sindh High Court in case of Muhammed Umer vs CIT reported as 2009 PTD 284 has held that a case falling under presumptive tax regime can also be selected for audit

- 2) If a case has been selected for Audit in preceding Two years, can it be selected for Audit for Third year?

Yes. Section 177(7) of I.T.Ord., 2001 permits this

- 3) Can an Addl. Commissioner while assuming jurisdiction u/s 122(5A) ask the tax payer to provide evidence, documents, details ?.

**No. Fact finding and roving -fishing inquiry is beyond the scope of sec 122(5A) proceedings
Please see case reported as 2010 PTD 111**

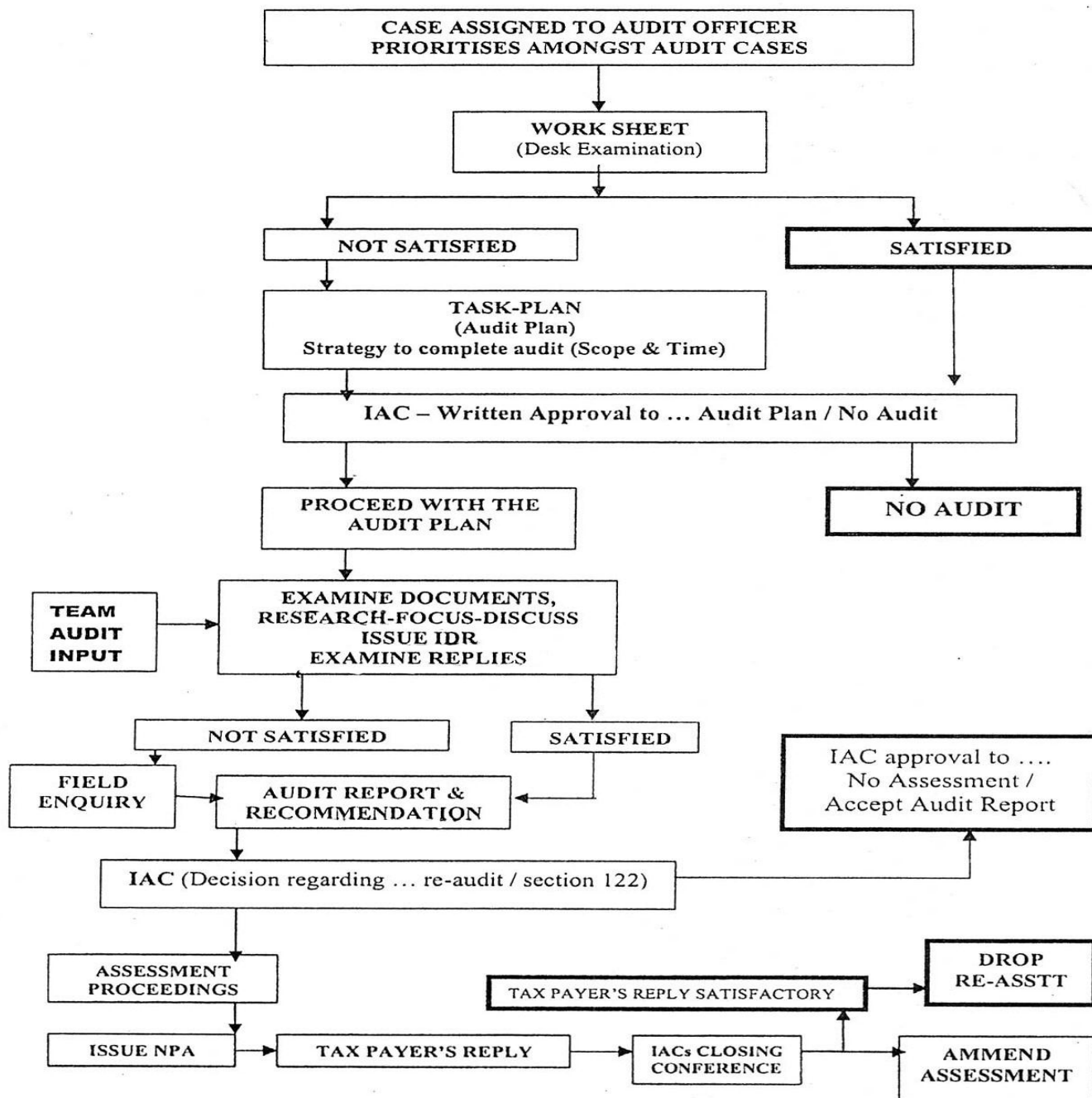
- 4) Can the Taxation Officer while conducting Audit u/s 177 for Tax Year 2010, ask the taxpayer to produce record for Tax year 2006?.

Yes. Second proviso to sec 177(1) permits the tax official to call for records upto six years from the end of tax year for which he is conducting the proceedings.

- 5) If a case has been selected for audit and assessment amended u/s 122, can the amended order be further amended u/s 122(5A) by treating it as erroneous and prejudicial to the interest of the revenue?

Yes: please refer to decision of Hon. Sindh High Court at Karachi in case of Nobel (Pvt) Ltd vs CIT reported as 2009 PTD 841

FLOW CHART – AUDIT



THANK YOU.

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