

Audit and Assessment under the Income Tax Law

By

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AUDIT DEFINED

- ❖ Relatively new concept as compared to **total audit** or **detailed scrutiny** of the past

The term audit has neither been defined in the Income Tax Ordinance 2001 nor in the General Clauses Act. However, the term defined in various dictionaries and judicial pronouncements means:

- (1) to make an official , systematic examination of accounts
- (2) inspection and verification, by Tax Authorities, of a taxpayer's return or other transactions possessing tax consequences. Systematic inspection of accounting records involving analysis, tests and confirmations.

(3) is a systematic and meticulous scrutiny of accounts with reference to the receipts and disbursements and vouchers and allied matters and submission of a report surveying the final outlay and highlighting the lapses or infirmities in the maintenance of accounts or utilization of funds. The report submitted by the auditor on an in-depth probe into the transactions with reference to accounts and other matters is expected to mirror the correct state of affairs.

{(A.S. Sharma. V. Union of India
(1988) 175 ITR 260(A.P)}

Audit under Income Tax Ordinance, 2001

- Section 177 – Selection for audit by the Commissioner
- Section 214C - Selection by the FBR through random or parametric computer balloting

Conduct of Income Tax Audit

- Officer has to allow opportunity u/s 177(6) before embark upon amendment u/s 122.
- CIR may assign Audit conduct to

Sec 210:-

- Officer of Inland Revenue
- Charter Accountant appointed by him or by the Board
- Audit panel appointed by the Board

Departmental viewpoint on selection u/s 177

- Both sections 177 and 214C are independent and both i-e Commissioner as well as Board are empowered to order for audit.
- While CIR exercising powers has to record reasons before embark upon audit
- Whereas CIR is not obliged to record reason when Board direct audit u/s 214C
- Explanation in section 214C and 177 further clarified that both authorities can exercise powers for audit

Selection for audit u/s 177 of the IT Ordinance

- Taxpayer's point of view
- Sindh High Court dismissed CPs filed by the taxpayers. 2016 PTD 1214 [Norinpaco & Others Vs Federation] Decided on 25-08-2015

- Latest position of litigation on the issue of selection for audit:-
- Lahore High Court judgment in ICA 855 of 2014 Dt 17-11-2017 [FBR etc. Vs M/s Chenone Stores Ltd]
- Single Bench decision in Chenone Stores' Case
The CIR has no power to select for audit, in presence of FBR's power u/s 214C.
- Single Bench decision in Kohinoor Sugar Mills' Case
The CIR has independent power to select for audit, under Section 177, in presence of FBR's power u/s 214C.

- ICA 855 of 2014 Dt 17-11-2017 decided in favour of Department upholding SB judgment in Kohinoor Sugar Mills' Case
- **Main points** of the judgment in ICA 855 of 2014 Dt 17-11-2017:-
 - Discretion u/s 177 should not be used to call a taxpayer consecutively to meet budgetary targets of collecting tax. In subsection (7) of the Section 177.
 - In section 177(7) the legislature has authorized audit of a taxpayer in the next and following tax years but only where there are reasonable grounds for doing so. These reasonable grounds need to be confronted, in addition to the reasons for selection required under the first proviso.
 - Legislature deprecates, as a rule, selection or calling for record of a taxpayer every year.
 - Calling for record in the next or following year should be in exceptional circumstances on very sound reasons

Frequent audit selection

- Sub section (7) of section 177 permits audit of next year despite of last year's audit
- CIR applies this provision every year and creates hardship
- Clause (105) of Part IV of Second Schedule inserted through F.A.2018 imposed bar for selection of audit u/s 177 and 214C for next three years.
- If necessary CIR may seek Board's approval for exemption from this bar

Special audit panel

- ⦿ Through F.A 2018 a major change is introduced through sub section (11) to (17) in section 177
- ⦿ Two or more members may conduct special audit through a panel of experts and FBR officers. Hence concept of '**JIT**' in revenue audit is evolved
- ⦿ Provision of forensic audit through panel is provided
- ⦿ Even foreign expert can be called for special audit
- ⦿ Board is empowered to frame rules for working of special panel
- ⦿ Panel is fully equipped with legal powers necessary for conduct of audit

Automatic audit selection

- Section 214D provides for automatic selection of case for audit when taxpayer files return after due date.
- This provision created capacity issues for workforce of FBR
- Meanwhile the late filers were entitled to enjoy all benefits of ATL being filer
- Through F.A 2018 section 214D deleted,
- And new section 182A restricts entitlement of ATL to filers within due date ONLY

Automatic audit closure

- Through section 214E a taxpayer may opt for closure of automatic selection of audit u/s 214D in following manner:
 - By 31Dec 2018
 - Pay 25% more tax of tax paid with return
 - or pay 2% of turnover tax,
 - If both options do not apply, pay penalty for late filing of return
 - CIR may select for audit on the basis of definite information or otherwise

Significance of sections 177(6), (7), (10), (11), (12), (13), (14), (15) & (16)

- CIR, RTO, Hyderabad Vs **Dr Muhammad Azeem Almani [(2015 PTD (Trib)1242)]**
- **Honda Fort Vs CIT** 2009 PTD 20 (HC Lah)
- CIR (Legal) Vs CIR (A) 2013 PTD 837 & CIT Vs M/s Duaba Plastic Industries 2015 PTD 681
- Judgment of Supreme Court of Pakistan in Civil Appeal No 526/2013 confirming judgment of Lahore High Court reported as 2013 PTD 837

How many times a taxpayer can be selected for audit in a year

- Can second audit be called for the same tax year?

- **Income Tax** – **No**

2011 PTD 1558 (HC Kar) [M/s **Shahnawaz** Ltd Vs Pakistan]

Completion of audit

- SCP in case CIR v/s Allahdin Steel 2018 PTD 1444 held
 - > To finalize audit within timeframe of audit policy
 - > Breach of timeline should be avoided at all cost
 - > However Board by recording plausible reasons may extend timeline on case to case basis

ASSESSMENT. v. AUDIT.

Assessment is defined as **recording of TAX LIABILITY or Refund in the books.** If any discrepancy or transaction contrary to the INCOME TAX LAW or generally accepted ACCOUNTING procedure, during an Audit or otherwise, is detected an amended assessment is made on the basis of such detection..

Audit is different from assessment

Forensic Audit

AUDIT DOES NOT AND SHOULD NOT NECESSARILY LEAD TO AN ASSESSMENT OR AMENDED ASSESSMENT IN EVERY CASE.

1965 کی جنگ کے 50 سال



1965 کی جنگ کے دوران فیلڈ مارشل محمد ایوب خان اگلے مورچوں کے دورہ کے موقع پر فوجی جوانوں سے مل رہے ہیں

Assessment defined

- Sub section (5) of section 2 of ITO,2001 defines
- "assessment" includes provisional assessment, re-assessment and amended assessment and the cognate expressions shall be construed accordingly

What is Cognate expression

- > Computation of income
- > Determination of tax payable
- > Procedure laid down in the Ordinance imposing liability on the taxpayer or reducing refund
(Special provisions)
- > Modification through rectification
- > Appeal Effects
- > Best judgment assessment

Normal sequence of assessments

- ◉ Deemed assessment [Sec120]
 - What is a complete return [Sec 114(2)]
 - How an incomplete return becomes complete [Sec120(3) & (5)]
 - How an incomplete/invalid return becomes a valid return [Sec 120(3) & 120(6)]

Assessment under IT law

- This deemed assessment may undergo following actions
 - No further action : as such the Revenue accepted without further modification
 - May be subjected to audit u/s 177 or 214C
 - May be subjected to upward revision u/s 122(5A) if it was erroneous in so far prejudicial to the interest of revenue
 - officer may apply section 122(1) r/w 122(5) on the basis of definite information
 - Taxpayer may desire to revise return u/s 114(6) r/w (6A) and return is treated as an assessment order

TYPE OF ASSESSMENT

- Deemed Assessment Sections 120(1), 169(3)
- Best Judgment Assessment Section 121
- Amended Assessment Section 122
- Amended assessment on account of revision of return by the taxpayer. Section 122 (3)
- Amended assessment on the basis of definite information acquired from an audit or otherwise Section 122 (5)
- If the assessment order is considered as erroneous and prejudicial in the interest of revenue. Section 122 (5A)
- Provisional Assessment Section 123
- Consequential Assessment Section 124 (1)
- New Assessment Section 124 (2)
- Modification Assessment Section 124A
- Assessment in case of disputed property Section 125

BEST JUDGEMENT ASSESSMENT

In case of non-furnishing of return, in response to Notice u/s 114(3) or 114(4), non-furnishing of statement in compliance of notice u/s 115(5) or 143, 144 or 116 or as per 177(1) for failing to produce accounts, documents and records required to be maintaining u/s 174, during audit, the Commissioner may make assessment to the best of his judgment u/s 121 based on information or material on record.

Best Judgment Assessment Continued

For making best judgment:-

- a. History should be followed 2009 PTD 638 Trib
- b. There must be a speaking order 99 TAX 329 Trib
- c. Should not be passed for single default 29 TAX 192,
1987 PTD 39
- d. Should be proper, fair and not dishonest 1959 PTD 180 H.C.

Thank You!