

Audit & Assessment under Income Tax & Sales Tax laws

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Agenda

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SECTION - 1

Introduction – Audit & Assessment

Assessment – General concept

- The definition of the amount subject to taxation under a particular statute requires an analysis of the taxpayer's situation and of the legal provisions that apply to him;
- With the income tax as well as sales tax, the taxpayer submits a tax return providing information as to his occupation, his real and personal property, his professional expenditures, and other pertinent matters;
- The return, with the attached reports and statements, is meant to provide such complete information that the assessing tax official can rely on it to compute the correct tax;
- Assessment is thus a process whereby the tax liability of a taxpayer is determined and this process of determination which may including verification of underlying details and basis for the same can be termed as 'Audit'.

Tax Audit – General concept

Tax Audit Framework issued by the FBR – As quoted in Chenone's Judgement

- Under the current provisions of the tax laws (Income Tax Ordinance, 2001 (the Ordinance), Sales Tax Act, 1990 (the Act) and Federal Excise Act 2005), there is a system of self assessment that enables the taxpayer 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 taxpayer's confidence on this system, the selection of taxpayers 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 taxpayers.

SECTION - 2

Income Tax

Income Tax

Scheme of assessments under the repealed 1979 Ordinance

- Returns filed by the taxpayers were subjected to mandatory assessment process
- Self Assessment Scheme used to be announced every year
- Assessment based on evidence or record
- Best Judgement / Ex-parte assessment

Income Tax

Scheme of Assessment under the 2001 Ordinance

- Universal Self Assessment Scheme - returns filed deemed as assessment order
- Originally a return could only be amended subject to certain conditions
- Returns were expected to be audited under certain parameters only
- Paradigm shift from Assessment to Audit
- Subsequent insertion of section 122(5A)

Income Tax

VARIOUS FORMS OF ASSESSMENTS

Description	Section
Deemed Assessment	120
Best Judgment Assessment	121
Amended Assessment	122
Amended assessment on account of revision of return by the taxpayer.	122(3)
Amended assessment on the basis of definite information acquired from as audit or otherwise	122(5)
If the assessment order is considered as erroneous and prejudicial in the interest of revenue.	122(5A)
Agreed Assessment (before assessment oversight committee)	122D
Provisional Assessment in the case of concealed or offshore asset	123
Assessment giving effect to appellate order	124
Modified Assessment	124A
Assessment in case of disputed property	125

Income Tax

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.
- 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.

Income Tax

Evolution of section 177 & 214C

- Amendments and substitutions made around 12 times since inception
- Originally the Commissioner was empowered to select a case for audit within certain parameters
- Subsequently the Board was also empowered to lay down criteria for selection of cases for audit
- The Commissioner's power to select a case for audit was linked with Board's criteria
- The Commissioner was empowered to select any case for audit whereas Board was separately empowered through section 214C for balloting
- Empowerment to have the audit conducted by CA or ICMA Firms
- Concept of appointment of Special Audit Panels introduced which may have two or more members of prescribed qualifications

Income Tax

Controversies relating to tax audit

- Commissioner's powers to select a case for tax audit vis-à-vis Board's powers of selection – The matter is currently decided by Sindh High Court and other High Courts in Department's favour
- Opportunity of being heard before selection of a case for audit by the Commissioner
- Risk based parameters for FBR to select cases for audit under balloting but such risk parameters can be kept confidential
- Issuance of an Audit Report upon finalization of the Audit under section 177 before issuance of a formal notice under section 122

Income Tax

Development of Law and disputes there-on

Progress in the Law

Unbridled powers to Commissioners to select and conduct 177 audit - Section.

Powers bestowed to Board to establish selection criteria for audit.- Section 177
Commissioner allowed to select the cases as per Board's criteria- Section -177

Board given explicit powers to select cases for audit- Section 214C

Both Board and Commissioner can select the taxpayer for audit- Section 177 [Explanation]
Board allowed to keep selection parameters confidential- Section 214C(1A)

2001-2004



2004



2010



2013

Challenges by Taxpayers

Selection power should rest with the Board.
Commissioner should only conduct the audit.

Power bestowed to Board are without necessary enabling provision in law.

Resentments in FBR for restricting Commissioner function to administration only.
Taxpayers questioned the selection as less vivid and anonymity of criteria for selection.

The courts have held in several cases that Board and Commissioners both have independent powers to audit the taxpayers.

Income Tax

Steps / procedure followed in tax audit

- Selection of case under section 214C/ 177
- Intimation of selection for audit and the reasons therefor
- Information Document Request – generally through a notice under section 176
- Conduct of audit
- Audit completion leading to Audit report or objections in terms of section 177(6)
- Issuance of notice under section 122 in case of unresolved differences
- Passing of an amendment order

Income Tax

Steps are followed in amendment assessment proceedings through tax audit

The foremost condition prior to commencement of amendment proceedings under section 122 of the Ordinance is that after completion of audit the tax authority has to issue an audit report and provide an opportunity to settle the said issues raised during the audit proceedings.

In a decision of the Appellate Tribunal Inland Revenue reported as **2022 PTD 1319** dated March 14, 2022 held that for the purposes of invoking section 122 of the Ordinance, the audit report is mandatorily. Relevant provision are reproduced below:

“11. From the bare reading of sections 177(6) and 177(6A) it is evident that after completion of audit, authority has to issue an audit report, containing all the issue raised in audit and to provide an opportunity to settle the said issues prior to commencement of amendment proceedings.”

(emphasis is ours)

Income Tax

Procedure to be followed for show cause notice under section 111 for amendment of assessment under section 122 of the Ordinance

- Separate notices should be issued under section 111 and 122 of the Ordinance.

Income Tax

A new concept of E-Audit

- A new concept of E-Audit introduced by Finance Act, 2020 through section 177(2A)
- The failure to furnish requisite information may allow the finalization of audit on the basis of sectoral benchmark ratios (as defined) prescribed by the FBR
- The detailed procedure in this regard prescribed through Rule 231FA introduced with effect from July 1, 2021
- The procedure is almost similar to the one otherwise adopted except that the physical presence of taxpayer will not be required

Income Tax

Conditions followed in tax assessments under section 122(5A) of the Ordinance

The first and foremost condition to invoke section 122(5A) is that a deemed order of the Commissioner should be both **erroneous** and **prejudicial to the interests of revenue**. These conditions have to be fulfilled before initiating any action under the said sub section.

In a decision of the Appellate Tribunal Inland Revenue reported as **2017 PTD 1911** dated February 6, 2016 held that for the purposes of invoking section 122(5A) of the Ordinance, the following conditions should be mandatorily be present before the tax officer:

- i) There should be an error of law or apparent illegality in the existing order; and
- ii) There should be an apparent loss of revenue.

Income Tax

Provisional Assessment – Section 123

In case a **concealed asset** of any person is impounded by the department or an **undeclared offshore asset** of any person is discovered, a provisional assessment order or amended order may be issued before issuance of an assessment order or amended assessment order under sections 121 and 122.

The provisional assessment order or amended order shall be finalized as soon as practicable

Income Tax

Assessment giving effect to an order – Section 124

In consequence of or to give effect to the order / judgement of the CIRA, Tribunal, High Court or Supreme Court:

- In respect of **direct relief** by CIRA or Tribunal, the Commissioner shall issue appeal effect within 2 months of the service of the order;
- If the assessment order is **set aside** and the Commissioner is directed to pass a new assessment order, the Commissioner shall pass the order within **one year** from the end of the financial year in which the order is served to the Commissioner;
- If any **directions or findings** are made by the higher forum, the Commissioner shall pass the order within **two year** from the end of the financial year in which the order is served to the Commissioner

Income Tax

Powers of tax authorities to modify orders – section 124A

- Where a question of law has been decided by the High Court or the Tribunal in the case of the taxpayer, the Commissioner **may follow the said decision** in the case of the said taxpayer so far as it applies to the said question of law **until the decision of the HC or the Tribunal is reversed or modified**
- In the case the decision is reversed or modified, the Commissioner may, **within a period of one year** from the receipt of the decision, modify the assessment order or the order in which it was applied.

Income Tax

Assessment in relation to disputed property – Section 125

Where the ownership of the property, the income of which is chargeable to tax is disputed in any Civil Court in Pakistan, the assessment order or amended assessment order in respect thereof may be issued **within one year after the end of the financial year** in which the decision of the Court is made.

Income Tax

Time Limitations

- Have to be read in terms of section 174(3) whereby the record has to be ordinarily kept for **six years** from the end of the tax year to which it relates
- Furthermore, the time limitation of taking an action under section 122 is **five years** from the end of the tax year in which the return is filed
- There is no prescribed time period for completing the audit process, however, as per the audit policy issued by the FBR for the respective period, such time period is prescribed and recommended to be followed
- For completion of action under section 122, now a period of **180 days** is prescribed

Income Tax

Direct Recourse to the Court

A Constitutional Petition Under Article 199 of the Constitution can be considered in case of audit proceedings violates taxpayers fundamental rights.

Following can be certain instances where such rights can be considered as been violated

- A notice is issued without jurisdiction
- The case time barred in terms of section 122 or 174
- Amending an already amended assessment
- Intrusion into Commissioner's power to select cases for audit [sectoral audit selections]

Representation before tax authorities during the interim/ transitional period should be done carefully.

SECTION - 3

Federal Sales Tax

Federal Sales Tax

Assessment of tax – Section 11

- Prior to 2012, section 36 also provided for assessment of tax which was then merged into section 11
- Assessment powers under section 11 are subject to the cases provided for within the provisions of section 11, such as non filing of return or short payment of tax due to miscalculation, non-payment or short payment of tax due to other reasons, collusion or deliberate act, inadvertence and non withholding of sales tax
- A show cause notice has to be issued within **5 years** from the end of the tax period
- Proceedings have to be completed within the specified time period (i.e. 120 days plus 90 days) subject to extensions and condonations

Federal Sales Tax

Tax Audit – Sections 25 & 72B

- Parallel to the provisions of section 177 of the Income Tax Ordinance, 2001
- The powers of Board under section 72B for selection of cases through balloting similar to section 214C of Income Tax Ordinance, 2001
- Powers of the Commissioner or authorised officer to call for records
- On the basis of such record, audit can be conducted **once in a year**, however, mere audit by AGPR does not preclude a re-audit by the Commissioner
- In case of a tax fraud or evasion of tax, an authorised officer can conduct an inquiry or investigation under section 38
- The concept of audit report is not expressly mentioned but the provisions are worded to convey such intention
- After completion of audit, necessary action can be taken under section 11 on any points of differences

SECTION - 4

Sindh Sales Tax

Sindh Sales Tax

Assessment of tax – Section 23

- AC-SRB makes assessment of SST liability on the basis of audit, inquiry, inspection or otherwise
- In absence of information / return / records, AC-SRB can assess the SST liability on the basis of available information / material, determining the Minimum Tax Liability
- MTL is not final liability, which is determined as result of audit, special or forensic audit
- Show cause notice can be issued within **8 years** and Order is required to be passed within **180 days**, extendable for 60 days excluding the time of adjournments
- Amendment in assessment order is also authorized
- Generally, SRB makes assessments on the basis of desk audits focusing on disclosures as per audited financial statements / accounts

Sindh Sales Tax

Tax Audit – Section 28 read with section 27

- In case, the Commissioner has any information of tax fraud or evasion may authorise the tax officer to call for records to conduct an inquiry or investigation under section 48
- On the basis of such information, audit can be conducted once in a year, however, may or may not be in addition to any audit carried out for the same period
- Audit proceedings shall be conducted through issuance of audit notice, however, the tax officer can also conduct the audit in the premises of the taxpayer for records verification with the permission of the Commissioner
- The tax officer will initially issue a notice to the taxpayer containing observations arise while conducting audit proceedings for clarification. The taxpayer may submit the response to the said notice within a period of 21 days from the receipt of audit observations notice

Sindh Sales Tax

Tax Audit – Section 28 read with section 27

- In case, no / unsatisfactory response furnished by the taxpayer within a specified period (i.e. 21 days), the tax officer shall issue an **audit report** specifying the amount of tax not paid by the taxpayer or any other violation of any provision of the Act or rules
- After completion of the audit the tax officer shall pass an order in accordance with the provisions of section 23 or 47 alongwith applicable penalty and default surcharge

Sindh Sales Tax

Time Limitations

- Have to be read in terms of section 27(1) whereby the record has to be ordinarily kept for a period of **ten years** from the end of the tax period to which it relates or till the final decision in any proceedings, if any

Sindh Sales Tax

Controversies relating to Sindh Sales Tax

- Scope and jurisdiction of Provincial Sales Tax laws
- Allocation / distribution of Service Revenue and resultant output tax – e.g. Telcos
- Adjustment of input tax – cross provincial
- Time limitation for assessment proceedings under section 23 (5 years Vs 8 years – Judgment of SHC)
- Issuance of generic notices under section 52
- Issuance of assessment notice under section 23 on Pan-Pakistan basis
- Concept of collection of tax through Reverse charge mechanism and the admissibility of input tax thereon
- Element of Service (Judgement of SHC & SCP in renting of immovable property services, business support services, security agencies, labour and manpower)

Sindh Sales Tax

Controversies relating to Sindh Sales Tax

- Concept and responsibilities of Collecting Agents
- Reimbursement of expenses – SHC judgment in Labour and manpower services
- Collection of Indirect tax through WHT mechanism
- Legality of the WHT Rules – SHC Judgement in the case of Fatima Fertilizer

Questions

&

Answers