

Form No: HCJD/C-121.
JUDGEMENT SHEET
IN THE ISLAMABAD HIGH COURT, ISLAMABAD
JUDICIAL DEPARTMENT

Writ Petition No. 272 of 2021

M/s Pakistan Tobacco Company Limited

Vs

Federation of Pakistan through the Secretary, M/o Finance, etc.

PETITIONER BY:

M/s Hyder Ali Khan and Shaheer Roshan Shaikh, Advocates for petitioners in Writ Petitions No. 1499 of 1507 and 1600 to 1606 of 2021.
Sirdar Jamal Sukhera and Sirdar Ahmed Jamal Sukhera, Advocates for petitioners in Writ Petitions No. 1265 to 1269 & 2237 of 2021.
M/s Hassan Kamran Bashir and Arif Humayun, Advocates for the petitioner in Writ Petition Nos. 272 and 2202 of 2021.
Hafiz Muhammad Idrees and Syed Farid Bukhari, Advocates for petitioners in Writ Petitions No. 1052, 1373, 1374, 1391, 1392, 1393, 1394 and 2364 of 2021.
Mr. Aamir Ahmed Khawaja, Advocate for petitioners in Writ Petitions No. 1168 to 1175 of 2021.
Ch. Naeem ul Haq and Ch. Imran ul Haq, Advocates for petitioners in W.P No. 1590 to 1594 of 2021.
Sahibzada Uzair Hashim, Advocate for petitioner in W.P No. 2409/2021.
Mr. Muhammad Musawar Gill, Advocate for petitioner in W.P No. 2287/2021.

RESPONDENTS BY:

Mr. Farrukh Shahzad Dall, Assistant Attorney General.
M/s Saeed Ahmed Zaidi, Barrister Atif Rahim Burki, Babar Bilal and Sheikh Anwar ul Haq Advocates for the respondents.

DATES OF HEARING: 01.07.2021, 06.07.2021, 12.07.2021,
28.07.2021, 23.09.2021 & 01.10.2021.

BABAR SATTAR, J.- - This judgment shall decide the instant petition, as well as petitions listed in the Schedule attached hereto, that impugn notices for purposes of audit under section 177(1) of the Income Tax Ordinance, 2001, section 25 of the Sales Tax Act, 1990 and section 46 of the Federal Excise Act, 2005, on the ground that such notices have been issued without lawful authority and in breach of provisions of the law.

2. The fundamental question involved in these petitions relates to the statutory prerequisites for exercise of authority by the Commissioner to conduct an audit under section 177(1) of the Income Tax Ordinance, 2001 (**"Ordinance of 2001"**), and sections 25 and 46 of the Sales Tax Act, 1990 (**"Sales Tax Act"**) and the Federal Excise Act, 2005 (**"Federal Excise Act"**), respectively. The additional question raised in some of the petitions is whether the Commissioner is vested with authority under section 177(1) of the Ordinance of 2001 to select a taxpayer for audit independent of any selection by the Federal Board of Revenue (FBR) under section 214C of the Ordinance of 2001, even though it was conceded that the said question has been decided by a larger bench of this Court in **Pakistan Telecommunication Company Ltd. Vs Federation of Pakistan (2016 PTD 1484)**. A further question that arises in view of the arguments made on behalf of FBR is whether the petitions are maintainable in view of the fact that selection for audit does not cause an actionable injury.

3. Let us start by summarizing the arguments of the learned counsels for the parties followed by review of the scheme of the statutes in question as well as judicial pronouncements enumerating the scheme of such statutes, followed by the opinion of this Court.

4. Mr. Hyder Ali Khan, learned counsel for the petitioners in Writ Petitions No. 1499 to 1507 and 1600 to 1606 of 2021 took the Court through the case law in relation to audit over various time-periods in view of amendments introduced within the Ordinance of 2001. His basic contention was that by circulars dated 01.03.2021 and 10.03.2021 FBR instructed Commissioners to audit oil marketing companies and prescribed timelines for the purpose of selection for audit, generation of audit reports, issuance of show cause notices and subsequent assessment orders. He submitted that such directive issued by the FBR was binding on the Commissioner, which fettered the discretion vested in the Commissioner to exercise his authority under section 177(1) of the Ordinance of 2001, independent of the FBR, and the initiation of an audit on the basis of such illegal directive was unlawful and based on an extraneous consideration. He submitted that FBR was vested with the authority under section 214C of the Ordinance of 2001 to select a person for audit in compliance with requirements of such section, and such audit could be random or parametric. But that FBR had not undertaken such exercise and instead issued directions to Commissioners in order to force the exercise of discretion by the Commissioners under section 177(1) of the Ordinance of 2001 in an unlawful manner. Mr. Hyder Ali Khan further submitted that a taxpayer has a right to be treated in accordance with law and to the extent that the power under section

177(1) was exercised in a manner in breach of statutory prerequisites, the consequent selection for audit in exercise of such power was unlawful and liable to be set aside. He submitted that exercise of authority by the Commissioner under section 177(1) of the Ordinance of 2001 on the basis of a directive issued by FBR suffered from *mala fide* in law and was amenable to the jurisdiction of this Court. He submitted that a sectoral audit letter instructing Commissioners to audit taxpayers falling within such sector was motivated by FBR's desire to meet certain revenue targets, which amounted to ordering an audit for a collateral purpose. He further submitted that exercise of authority under section 25(1) of the Sales Tax Act, 1990, selecting the petitioner for a sales tax audit and under section 46 of the Federal Excise Tax Act, 2005, also suffered from infirmity as such audit was based on an illegal directive issued by the FBR. He submitted that Sales Tax Act, 1990, did not make any allowance for a composite audit. He further contended that section 25(1) & 25(2) of the Sales Tax Act provide for a two step-process for selection of audit. That step one was the issuance of notice together with reasons seeking the record of the taxpayer. And at step two a taxpayer could be selected for audit based on application of mind by the Commissioner on the basis of scrutiny of the record procured under section 25(1). He submitted that section 25 of the Sales Tax Act did not conceive issuance of notices simultaneously for selection of audit as well as provision of record.

5. Sirdar Ahmed Jamal Sukhera, Advocate for petitioners in Writ Petitions No. 1265 to 1269 and 2237 of 2021 submitted that reasons in the impugned notices fell short of the required standard of the

issuance of notices and the absence of reasons that could be deemed reasonable constituted a jurisdictional defect amenable to the writ jurisdiction of this Court. He submitted that in accordance with the judgment of this Court in **Pakistan Telecommunication Company Ltd. Vs Federation of Pakistan (2016 PTD 1484)** the Commissioner was under an obligation to formulate criteria prior to exercise of powers under section 177(1) of the Ordinance of 2001, which had not been done in the instant case. That power of selection for audit could not be left to the whims of the Commissioner and his unguided discretion and the impugned audit notices were liable to be set aside as neither any pre-determined criteria had been specified by the Commissioner nor had reasons been recorded that satisfied the reasonability test. He submitted that any show cause notice, issued on the basis of an audit report that was a product of audit notices that suffered from legal infirmity, was also not sustainable in the eyes of law and was liable to be set aside. He submitted that there was a remedy provided under section 7 of the Federal Board of Revenue Act, 2007 ("**FBR Act**"), but such remedy was illusory. And even otherwise it was settled law that if any order suffered from jurisdictional defect, an aggrieved person could seek relief from the High Court against wrongful assumption of jurisdiction by a public authority.

6. Hafiz Muhammad Idrees, ASC for petitioners in W.P No. 1052, 1373, 1374, 1391, 1392, 1393 1394 and 2364 of 2021 submitted that the Commissioner had no independent authority to select taxpayers for audit under section 177 of the Ordinance of 2001 and that the selection had to be made by FBR under section 214C of the Ordinance of 2001 after which it was for the Commissioner to undertake the audit

pursuant to provisions of section 177 of the Ordinance of 2001. He submitted that this Court in **Pakistan Telecommunication Company Ltd.** had not agreed with the contention of the petitioner that section 177(1) was to be read together with section 214C of the Ordinance of 2001 and cross appeals had filed against the said judgment by taxpayers and the FBR, which were pending adjudication before the august Supreme Court. His contention was that the petitioners have not been selected for audit under section 214C of the Ordinance of 2001 and consequently notices intimating selection of petitioners for audit under section 177(1) were without jurisdiction. His second submission was that even if the law as laid down by this Court in **Pakistan Telecommunication Company Ltd.** were to be followed, the Commissioner was obliged under section 177(1) of the Ordinance of 2001 to record reasons for selection of a taxpayer for audit and communicate the same to the taxpayer and then afford the taxpayer an opportunity to be heard and to raise objections against the selection, which had not been done in the instant case and consequently the audit proceedings were in breach of the petitioners' right to be heard prior to initiation of audit under section 177(1) read together with Article 10A of the Constitution. He further submitted that the Commissioner was under a statutory obligation to undertake audit selection on the basis of predetermined criteria and the reasons for selection had to meet the test of reasonability, and as the said requirements had not been met in the instant case, the audit notices suffered from jurisdictional defect. He submitted in relation to audit notices issued under sections 25 and 46 of the Sales Tax Act and Federal Excise Act, respectively, that the Commissioner was obliged to

give reasons for selection of audit and such reasons could not be arbitrary. And that in the case of the petitioners, they had been simultaneously selected for audit for four consecutive years and such selection was arbitrary. He submitted that the selection of the petitioners for audit for consecutive years was not supported by any reason and it appeared that the petitioners had been selected for audit for all years within the limitation period, and therefore such selection was discriminatory and *mala fide* and not backed by legitimate reasons.

7. Ch. Naeem ul Haq, Advocate for petitioners in Writ Petitions No. 1590, 1591, 1592, 1593, 1631, 1632, 1633, 1672 and 2547 of 2021 adopted the arguments of Hafiz Muhammad Idrees, Advocate.

8. Mr. Hassan Kamran Bashir, Advocate for petitioners in Writ Petition Nos. 272 and 2202 of 2021 submitted that the petitioner's selection for audit under section 25 of the Sales Tax Act and 46 of the Excise Act was a two-step process. That in the first instance the Commissioner was under an obligation to give reasons for summoning record. It was on the basis of review of the record that the Commissioner could then select a taxpayer for audit under section 25(2) of the Sales Tax Act. He submitted that the authority vested in the Commissioner was discretionary in nature and exercise of such discretion had to be structured and the course of action adopted had to be the product of independent application of mind to the facts and circumstances of the case. He submitted that the impugned notices suffered from legal infirmity as they were issued without discharge of mandatory obligations under section 25(1) of summoning record subject to a reasoned order. That the power under section 25(2) of the

Sales Tax Act had been used to directly select the petitioners for audit and consequently the Commissioner placed the cart before the horse. He submitted that in the event that the impugned notices were found to be lawful it would render section 25(1) of the Sales Tax Act, 1990 redundant.

9. Mr. Saeed Ahmed Zaidi, Advocate for the respondent/FBR, submitted that the petitions were not maintainable as it had been held by the august Supreme Court in **Commissioner of Inland Revenue, Sialkot Vs. Allah Din Steel and Rolling Mills (2018 SCMR 1328)** that mere selection for audit did not constitute an actionable injury. He submitted, after adverting to the legislative history of audit powers under the Ordinance of 2001, that under section 214C the FBR is vested with an independent power to select a taxpayer for audit and such power had no co-relation with the power vested with the Commissioner under section 177(1) of the Ordinance of 2001. He submitted that under the self-assessment scheme introduced through the Ordinance of 2001, a taxpayer was under an obligation to pay tax and the State had been granted requisite tools in the form of power to conduct audit to ensure that a taxpayer had correctly declared his income. He submitted that section 177 did not conceive of a pre-audit selection adjudicatory process and did not require an opportunity to be provided to a taxpayer to be heard prior to his selection for audit, and that such obligation could not be read into the statute. He submitted that this Court in **Pakistan Telecommunication Company Ltd.** had not declared that there was an obligation on part of the Commissioner to provide a taxpayer an opportunity to be heard prior to initiating an audit against him and that it was in the peculiar facts and

circumstances of the cases being adjudicated that the Commissioner had been directed to hear the objections of taxpayer prior to initiating an audit. He submitted that FBR had given directions to the Commissioners to audit various sectors and such directions were binding on the Commissioners in terms of section 206 of the Ordinance of 2001. And that in view of such binding directions, the Commissioners had looked into the facts of each taxpayer's case within the identified sectors and subsequently proceeded in accordance with the requirements of section 177(1). And consequently, the impugned notices suffered from no legal infirmity merely because they were the consequence of directions issued by FBR. He submitted that audit process envisaged three stages. That at the first stage, under section 177(1) of the Ordinance of 2001, a taxpayer was selected for audit and was directed to produce relevant record together with furnishing of reasons by the Commissioner for exercise of such authority to audit a taxpayer. That at the second stage, prior to culmination of the audit, the taxpayer was confronted with concerns that emerged during the process of the audit and the auditor then gave its findings after seeking explanations from the taxpayer and the audit thus ended with the issuance of an audit report. And that at stage three, in the event that the audit report reflected that reassessment of the income tax return filed by the taxpayer was called for, an appropriate notice was issued under section 122, wherein the taxpayer was once again provided an opportunity to be heard prior to imposition of additional tax liability. And in view of the aforementioned scheme, a taxpayer could not claim to have suffered an injury merely on the basis of being selected for audit. He submitted that the writ

petitions were not maintainable in the event that a fresh demand was generated on the basis of audit report. That the Ordinance of 2001 provided for appropriate statutory remedies. And even otherwise under section 7 of the FBR Act a remedy had been afforded to the petitioners, which had not been availed.

10. Mr. Atif Rahim Burki, Advocate for the respondent submitted written arguments that raised objections to maintainability of the petitions and also reiterated that the impugned notices suffered from no illegality. He submitted that all of the objections raised by the petitioners to the authority of the Commissioner to select a taxpayer for audit under section 177(1), as well as the requirements of law to be satisfied in doing so, had already been addressed by the superior courts and the only question of law before this Court was whether in view of the law laid down by a larger bench of this Court in **Pakistan Telecommunication Company Ltd.** the petitioners had a statutory right to be heard under section 177(1) of the Ordinance of 2001 prior to initiation of an audit.

11. In rebuttal, the learned counsel for the petitioners drew the attention of this Court to the following judgments of the learned Lahore High Court and the learned Sindh High Court:

- (i) W.P No. 37251/2021 titled Raza Motor Industries Vs. Federation of Pakistan decided on 14.06.2021.
- (ii) W.P No. 25793/2021 titled Hyundai Nishat Motor Pvt. Limited Vs FBR decided on 14.09.2021.
- (iii) Suit No. 850/2020 titled Dewan Sugar Mills Vs. Federation of Pakistan decided on 09.08.2021

It was submitted that the learned Sindh High Court as well as the learned Lahore High Court had found that summoning of record for

purposes of audit under section 25(1) of the Sales Tax Act was a stage independent of selection for audit under section 25(2) of the Sales Tax Act and notices for both purposes could not be issued simultaneously. And that the Commissioner was under an obligation to record reasons for summoning of record under section 25(1) of the Sales Tax Act. It was further brought to the attention of this Court that in **Raza Motor Industries** the learned Lahore High Court had found that the two-stage process envisaged under the Sales Tax Act for selection of audit was not applicable under section 177 of the Ordinance of 2001.

12. The history of evolution of audit powers under the Ordinance of 2001 has been dealt with in detail in **Messrs Chenone Stores Ltd. v. Federal Board of Revenue (2012 PTD 1815)** as well as **Pakistan Telecommunication Company Ltd. Vs Federation of Pakistan (2016 PTD 1484)** and need not be recapitulated here once again. This Court will address the scheme of the Ordinance of 2001 initially and subsequently deal with the scheme of audit under the Sales Tax Act and the Federal Excise Act. It is by now well settled that the State has a right to tax its citizens and the citizens are under an obligation to pay their fair share of tax liability. The Ordinance of 2001 envisages that the enforcement of such right and obligation will be through a self-assessment scheme, which was a change from the assessment mechanism provided under the Income Tax Ordinance of 1979. Under section 120(1) of the Ordinance of 2001 the return of income filed by a taxpayer is deemed to be an assessment of taxable income by the Commissioner. Section 120(1A) provides that notwithstanding section 120(1), the Commissioner may conduct the audit of the income tax affairs of a taxpayer under section 177 of the

Ordinance of 2001. Section 120(1) and 120(1A) reflect that on the one hand the State wishes to repose its trust in the taxpayer and assume that the income declared by such taxpayer will be truthful and will thus to be deemed an assessment order. But simultaneously under section 120(1A), the legislature grants the Commissioner the requisite tool to subject a taxpayer's income tax returns to scrutiny. This scheme reflects the legislative intent behind section 177 of the Ordinance of 2001 i.e. to equip the Commissioner with an effective tool to scrutinize the tax affairs of the taxpayer when he has reasonable basis to conclude that the income declared might have been declared erroneously or untruthfully. Section 120(1A) reflects that exercise of power by the Commissioner under section 177(1) is meant to be focused on the return of an individual taxpayer and not for pursuit for any larger goal relevant for purposes of section 214C, as will be discussed later in this judgment. Section 121 provides for the best judgment assessment and amongst the incidences where such judgment is to be exercised includes, *inter alia*, the failure to produce accounts and records under section 177 of the Ordinance of 2001. Section 122(5) then provides that "*an assessment order in respect of 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 audit or on the basis of definite information.*" Section 122(5A) further provides for an amendment of assessment order if the assessment order is found to be erroneous and prejudicial to the interest of revenue. In this section the expression "definite information" includes information related to sales or purchases of any goods, receipts from services

rendered or otherwise chargeable to tax and information regarding acquisition, possession or disposal of any money or asset, valuable article or investment made or expenditure incurred. Section 177 read with sections 120, 121 and 122 reflects that audit by the Commissioner under section 177 is conceived to be a tool to ensure that a taxpayer filing income tax return provides a truthful account of his income. Section 127 provides for an appeal to the Commissioner but does not provide an appeal against an order selecting a taxpayer for audit. Section 122(9) provides that in the event that reassessment order is passed it can only be passed after providing the taxpayer an opportunity to be heard. In view of the aforementioned provisions, read together with section 177, 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 the Ordinance of 2001. The timeline provided in the proviso to section 177(1) corresponds to that for maintenance of records under section 174 as well as for passing of an order to amend an assessment under section 122 of the Ordinance of 2001. It is patent that that the object of creating the power to conduct audit under section 177, as the law now stands, is to enable the Commissioner to audit books and accounts of a taxpayer in the event that he has reasonable basis to conclude that the return filed on self-assessment basis does not record the true taxable income of the taxpayer. The object is therefore to empower the Commissioner to undertake diligence in order to pass a reassessment order in relation to an individual taxpayer should the need arise, and not to pursue any larger goal for purposes of reshaping tax audit policy or carrying out

any study regarding the administration and efficiency of the tax regime on the whole. As the Commissioner is repository of the tax record of an individual taxpayer, it has been left to him to determine on the basis of a taxpayer's tax returns whether there is reason to believe that some of the taxable income has not been correctly declared, which calls for audit of his books and accounts. And if reasonable grounds are borne out of such audit proceedings, a reassessment order is to be issued.

13. It has been argued by the learned counsel for the petitioners that in the absence of predetermined criteria, selection of a taxpayer for purposes of audit is without jurisdiction. This Court has not been persuaded by this line of arguments. The erstwhile section 177 provided for selection of taxpayer for audit by the Commissioner as well as by the FBR and consequently section 177(4) dealt with the considerations to be borne in mind by the Commissioner in case of exercise of power by him selecting a taxpayer for audit. But after promulgation of section 214C, the powers of FBR and the Commissioner for purposes of selecting a taxpayer for audit have been separated. Erstwhile section 177(4) has since been deleted by the legislature in its wisdom. Section 177 as it now stands, deals exclusively with the powers of the Commissioner to select a taxpayer for audit. Consequently, there is no reason to confuse the factors to be borne in mind by the FBR when it exercises the powers to select a taxpayer for audit with those to be borne in mind by the Commissioner while exercising his audit selection powers. The focus on the Commissioner prescribing criteria for selection of taxpayers for audit also seems unnecessary in view of the scheme of assessment as

enumerated above. Even if one evaluates the factors mentioned in the erstwhile section 177(4) specifying the matters to be kept in mind by the Commissioner while exercising his audit selection powers, they did nothing other than to provide that where the Commissioner has reasonable basis to conclude that the income of a taxpayer has escaped taxation, he may exercise his discretion and chose to subject the books and accounts of such taxpayer to audit. The only requirement for exercise of such authority in view of erstwhile section 177(4), and section 177(1), as it now exists, is that the Commissioner must have reasonable basis for subjecting a taxpayer to audit. In other words, the Commissioner cannot initiate an audit on the basis of a hunch or suspicion or conjecture as held by this Court in **Pakistan Telecommunication Company Ltd**, as suspicion alone would not constitute reasonable basis to question the veracity of a return (i.e. deemed assessment) under section 120(1A). At the other end of the spectrum is a situation where the Commissioner has definite information that income of a taxpayer has not been subjected to tax. In face of information too the Commissioner need not undertake the exercise of audit and can simply issue a notice for purposes of reassessment in view of section 122(5). Thus, 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. In other words, reasonable basis would need to be a cogent cause leading the Commissioner to believe in view of the tax return of a certain financial year that such return does not capture the entire income of the taxpayer. Section 177(1) then mandates the Commissioner to document such reasonable basis that leads him to

believe that the taxpayer's income has escaped taxation and communicate the same to the taxpayer. There can be no exhaustive list of factors that the Commissioner must bear in mind and would constitute legitimate reasons for selection of a taxpayer for audit. It could be the ratio of revenue versus tax in relation to one taxpayer. It could be the claimed expenditure in relation to another taxpayer. It could be the ratio of receipts versus income for a taxpayer in a certain industry, and so on. The bottom line is that the Commissioner must have a reasonable and cogent basis to believe that the income of the taxpayers as declared by him through the self-assessment process does not constitute an accurate account of the income of such taxpayer that is chargeable to tax. But once the Commissioner applies his mind and gives reasons for why he believes that an audit is required to determine the accuracy of income tax affairs of the taxpayer, such reasons cannot be subjected to exacting judicial scrutiny. The power vested by the legislature in the Commissioner is of a discretionary nature and discretionary power by definition is the power to choose amongst more than one courses of action. Such exercise of discretion can only be interfered with when the reasons for exercise of discretion (i) are not just, fair and reasonable i.e. are not *bona fide* reasons which take into account relevant considerations and do not take into account extraneous considerations, and (ii) are not reasons in pursuit of the objects of the statute i.e. in pursuit of purposes for which such power has been granted. In the event that the exercise of discretion by the Commissioner does not fall foul of the aforementioned requirements, the reasons furnished by the Commissioner would receive deferential review from the court, as the

court would be loath to second guess the decision of the Commissioner merely because if it places itself in the shoes of the primary decisionmaker it might exercise discretion differently. However, to the extent that the exercise of discretion is found to be unreasonable or driven by extraneous considerations or inspired by objects other than the objects of the statute, the exercise of discretion would be liable to judicial review, as under Article 4 of the Constitution the decisionmaker is under an obligation to act in accordance with law and the taxpayer on the receiving end of such exercise of authority has a right to be treated in accordance with law. In such event, merely because selection of audit is not a final order or an order causing direct injury to the taxpayer would not be sufficient basis to clothe the exercise of authority by the Commissioner under section 177 with legality, when such authority has not been exercised in the manner as prescribed by law.

14. Under section 177(6), prior to issuance of an audit report containing observations and findings of the audit officer, law requires the audit officer to obtain the taxpayer's explanation on all issues that emerge from the audit. Consequently, under section 177(6) the taxpayer has a right to be heard and to furnish explanations in relation to the concerns of the tax department. In the event that the explanation of the taxpayer is not found satisfactory, the Commissioner can then exercise powers under section 122(1) & 122(2) read with 122(9) to require the taxpayer to show cause as to why reassessment order should not be passed. At the first stage of audit process, which involves the selection process for audit, the only obligation to be discharged by the Commissioner is recording reasons

for selection of the taxpayer for audit, which must constitute reasonable basis as explained above, and communicating the same to the taxpayer. The legislature has not provided the taxpayer with any right of hearing at this stage as is also borne out by section 127 of the Ordinance of 2001, which doesn't include an audit selection order amongst orders that are appealable. It is only where the Commissioner fails to furnish reasons for selection of audit or furnishes reasons that do not satisfy the test of reasonability, as explained above, that such notice can be challenged for having been issued in breach of requirement of section 177 of the Ordinance of 2001. The taxpayer has even been provided an opportunity to furnish explanations to the audit observations and concerns of the tax department under section 177(6). And then within section 122 is built an adjudicatory mechanism to be availed by the taxpayer to dispute any fresh demand generated by the tax department.

15. The power of the Commissioner under section 177 and the purpose and object of such power ought not to be confused with the power vested in the FBR under section 214C. This is evident from the object of section 177 and the explanation provided thereunder, as well as section 214C and the explanation provided thereunder. The said provisions are reproduced here for convenience.

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.

(2A) For the purpose of sub-section (2), the Commissioner may conduct audit proceedings electronically through video links, or any other facility as prescribed by the Board.

(a) has not furnished record or documents including books of accounts;

(b) has furnished incomplete record or books of accounts; or

(c) is unable provide sufficient explanation regarding the defects in records, documents or books of accounts,

it shall be construed that taxable income has not been correctly declared and the Commissioner shall determine taxable income on the basis of sectoral benchmark ratios prescribed by the Board.

Explanation.—The expression "sectoral benchmark ratios" means standard business sector ratios notified by the Board on the basis of comparative cases and includes financial ratios, production ratios, gross profit ratio, net profit ratio, recovery ratio, wastage ratio and such other ratios in respect of such sectors as may be prescribed.

(6) After compilation of the audit, the Commissioner shall, after obtaining taxpayer's explanation on all the issues raised in the audit, issue an audit report containing audit observations and finding.

(6A) After issuing the audit report, the Commissioner may, if considered necessary, amend the assessment under sub-section (1) or sub-section (4) of section 122, as the case may be, after providing an opportunity of being heard to the taxpayer under sub-section (9) of section 122.

(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 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), 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.

Explanation.— For the removal of doubt, it is declared that the powers of the Commissioner under this section are independent of the powers of the Board under section 214C and nothing contained in section 214C restricts the powers of the Commissioner to call for the record or documents including books of accounts of a taxpayer for audit and to conduct audit under this section.

(11) The Board may appoint as many special audit panels as may be necessary, comprising two or more members from the following:—

(a) an officer or officers of Inland Revenue;

(b) a firm of chartered accountants as defined under the Chartered Accountants Ordinance, 1961 (X of 1961);

(c) a firm of cost and management accountants as defined under the Cost and Management Accountants Act, 1966 (XIV of 1966); or

(d) any other person including a foreign expert or specialist as directed by the Board, to conduct an audit, including a forensic 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 case-to-case basis.

(e) a tax audit expert deployed under an audit assistance programme of an international tax organization or a tax authority outside Pakistan:

Provided that in case the member is not an officer of Inland Revenue, the person shall only be included as a member in the special audit panel if an agreement of confidentiality has been entered into between the Board and the person, international tax organization or a tax authority, as the case may be.

(12) Special audit panel under sub-section (1) shall be headed by a Chairman who shall be an officer of Inland Revenue.

(13) Powers under sections 175 and 176 for the purposes of conducting an audit under sub-section (11), shall only be exercised by an officer or officers of Inland Revenue, who are member or

members of the special audit panel, and authorized by the Commissioner.

(14) Notwithstanding anything contained in sub-sections (2) and (6), where a person fails to produce before the Commissioner or a special audit panel under sub-section (11) 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 panel, the Commissioner may proceed to make best judgment assessment under section 121 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.

(15) If any one member of the special audit panel, other than the Chairman, is absent from conducting an audit, the proceedings of the audit may continue, and the audit conducted by the special audit panel shall not be invalid or be called in question merely on the ground of such absence.

(16) Functions performed by an officer or officers of Inland Revenue as members of the special audit panel, for conducting audit, shall be treated to have been performed by special audit panel.

(17) The Board may prescribe the mode and manner of constitution, procedure and working of the special audit panel.

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.*

(1A) Notwithstanding anything contained in this Ordinance or any other law, for the time being in force, the Board shall keep the parameters confidential.

(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.

Explanation.— For the removal of doubt, it is declared that the powers of the Commissioner under section 177 are independent of the powers of the Board under this section and nothing contained in this section restricts the powers of the Commissioner to call for the record or documents including books of accounts of a taxpayer for audit and to conduct audit under section 177.

16. Let us briefly review how the power to audit the income tax affairs of a taxpayer has been enumerated by the learned High Courts and the august Supreme Court. In **Messrs Pfizer Pakistan Ltd. Vs. Deputy Commissioner And Others (2016 PTD 1429)** it was held by the learned Sindh High Court that the State has a right to collect tax for which purpose it has been vested with power to audit the affairs of taxpayers and the citizen has a corresponding obligation to pay tax and truthfully discharge his tax obligations. And that the discharge of such obligations and the enforcement of the state's right to ensure the same cannot be left to FBR's random or parametric selection process alone. It was held in **Kohinoor Sugar Mills Vs. Federation Of Pakistan (2018 PTD 821)** that sections 177 and 214C are independent provisions which are meant to coexist and do not require any correlation. It was further held that audit provisions are machinery provisions which are to be liberally construed and that audit was the beginning of the scrutiny process and not the end and was meant to verify the correctness of assessment. And that audit was a tool to evaluate the integrity of the self-assessment process, and provisions related to audit were not to be interpreted such that the state's power to scrutinize the correctness of tax returns stands undermined. It was also held by the learned Lahore High Court in the

said judgment that the Commissioner had a duty to give reasons as well as afford a taxpayer an opportunity to be heard at the pre-selection stage.

17. It has been argued before this Court on the basis of **Kohinoor Sugar Mills Vs. Federation Of Pakistan (2018 PTD 821)** as well as **Pakistan Telecommunication Company Ltd. Vs Federation of Pakistan (2016 PTD 1484)** that the taxpayer has a right to be heard under section 177(1) of the Ordinance of 2001 prior to the initiation of audit. In **Raza Motor Industries Vs. Federation of Pakistan (W.P No. 37251/2012 decided on 24.06.2021)** the learned Lahore High Court has taken the view that section 177(1) does not afford the taxpayer a right to be heard at the audit selection stage. It has held that the observation made by the learned Lahore High Court in **Kohinoor Sugar Mills** for granting an opportunity of hearing to the taxpayer after requisitioning of record and requiring the Commissioner to pass a reasoned order on any objections raised by the taxpayers do not have a basis in law. The learned Judge-in-Chambers opined that the direction issued in Kohinoor to afford hearing to a taxpayer was on the basis of a conceding statement on behalf of the learned counsel for the department.

18. Likewise, it has been argued by the petitioners that this Court in **Pakistan Telecommunication Company Ltd.** held that a taxpayer had a right to be granted an opportunity of hearing in the event that he raised objections to his selection for audit under section 177(1). The contention, however, seems misconceived. As the judgment of the larger bench is binding on this Court, let us reproduce the relevant excerpts of the said judgment.

18. *In any self assessment scheme audit is the most effective and efficient tool to verify the accuracy of the declarations made in the Returns, treated as an assessment order. This is the only process for the purposes of determining that correct income has been declared and the levied tax has been paid. In simple words, audit is an examination and inspection of documents, books, accounts etc.*

21... *Can an executive authority form an opinion for the purposes of taking a decision on a mere guess, suspicion or conjecture, or whether the threshold is higher? The process of forming an opinion inevitably requires the existence of certain facts and circumstances, and an application of mind. It is through this process that a Commissioner forms an opinion as to whether or not the matter is material for determination of the correct income. In other words the Commissioner has to be satisfied that 'reasonable grounds' exist for his/her opinion for making a selection. The existence of reasonable grounds, therefore, is a jurisdictional pre-condition to select a tax payer for an audit. The opinion as such must be based on facts and circumstances which to an 'ordinary, cautious and prudent person' would appear to be reasonable and which would go beyond mere conjecture, suspicion, guess or being illusory in nature. If the exercise of discretion appears to be for irrelevant reasons e.g. to conduct a roving enquiry or the selection made is arbitrary, it would not be sustainable as it would not be in consonance with the object of vesting such powers in the Commissioner.*

24. *The proviso to subsection (1) made it mandatory for a Commissioner to record the reasons in writing for the purposes of calling for the record, documents or books of accounts of the taxpayer and to communicate the same to the latter. This statutory duty must be fulfilled before calling for the records etc. The proviso, therefore, qualified or in other words circumscribed the powers of the Commissioner. The proviso, in fact, is the basis or criterion prescribed for exercising the powers contemplated under subsection (1). It is obviously implicit in the expression 'call for records--', the power to select. When subsection (1) is read in conjunction with the proviso, it unambiguously shows the legislative intent to vest the powers exclusively in the Commissioner, not only to conduct the audit but to select a person*

as well, subject to the jurisdictional pre-conditions prescribed in the proviso.

25 *...The proviso to subsection (1) of section 177 prescribes the jurisdictional pre-requisites for exercising the power and simultaneously implicitly includes the criterion for selection of a person who is required to produce the documents or records. Before calling for records etc the legislature has made it mandatory for a Commissioner to record the reasons in writing and communicate the reasons to the taxpayer while calling for the records etc. Recording of reasons inevitably requires an application of the mind, thereafter arriving at a conclusion or decision based on those reasons. The process is inherently premised on some definite criterion in the context of selection of a person being called to produce records or documents, otherwise recording of reasons in writing would lose its relevance. In order for a Commissioner to exercise powers under section 177 the first step is to identify or select the person whose records etc are to be audited. This necessarily involves a process of selection from amongst the taxpayers within his jurisdiction. On completion of the process of selection, there is a statutory duty to record the reasons in writing and communicate the same to the taxpayer. The reasons would be sustainable in law only if they could be justified on the basis of a criterion. The criterion for selection, or in other words in identifying a taxpayer for conducting an audit, is an integral part of the reasons required to be recorded in writing.*

26 *...There may be a situation when the Commissioner is of the opinion to select a particular person for conducting an audit on grounds other than those specified in the criterion laid down by him/her e.g. on the basis of some information relating to the latter. It may be that in the opinion of the Commissioner some matter other than the general criterion laid down by the latter is material to determine the correct income of a particular taxpayer. In such an eventuality what should be the minimum threshold of the standard of reasons to be recorded in writing? As already explained above, it cannot be stated in definite terms as to what standard of reasoning would be required in such a situation. Obviously it would depend on the facts and circumstances in each case...The reasoning, therefore, must be based on facts and circumstances*

which to an 'ordinary cautious and prudent person' would appear to be reasonable and which would go beyond mere conjecture, suspicion, guess or being illusory.

31. *Applying the said principles of interpretation, and in the light of the above discussion, we hold that by no stretch of the imagination can the powers of the Commissioner under section 177 be construed or interpreted as being subservient to the powers of the Board under section 214-C. The powers under both the provisions are exclusive and independent of each other...The language of sections 177 and 214-C is plain, unambiguous and, therefore, nothing can be read therein, nor is it within the domain of the Court to question the policy, wisdom or intent of the legislature. The legislature, by inserting the 'Explanation' in sections 177 and 214-C, has declared and reaffirmed the intention that the powers are independent and exclusive of each other.*

43. *Section 25 empowers the Commissioner to direct a person to produce the specified records, documents etc 'as and when required'. The expression 'as and when required' is crucial. The said expression limits the powers conferred under the provision. The Commissioner has to take a conscious decision, after application of mind, in the context of as and when the latter would require a person to produce the records etc. for audit. The Commissioners powers are, therefore, neither unguided nor unfettered. The Commissioner cannot pick and choose arbitrarily or capriciously. The language of section 25 unambiguously shows that the power to select is exclusively vested in the Commissioner and the selection is to be made as and when the latter requires such a person to produce the record etc. It is settled law that a person vested with power under a statute is obliged to exercise the same 'reasonably, fairly, justly and for the purposes of the enactment'. Moreover, a person making an order under powers conferred by any enactment shall, so far as necessary or appropriate, 'give reasons for making the order'. Reliance is placed on Mohammad Ashraf Tiwana and others v. Pakistan and others 2013 SCMR 1159. It is, therefore, implicit in the expression 'as and when required' to give reasons having regard to the object and purpose of section 25. The reasons ought to reflect the criterion determined by the Commissioner for selecting a person from amongst the taxpayers*

within his jurisdiction. The principles already discussed in detail in the context of section 177 of the Ordinance of 2001 would also be attracted when powers are exercised under section 25 of the Act of 1990. Section 25 itself makes a distinction between a routine audit and an audit when the Commissioner has information or sufficient evidence relating to tax fraud or tax evasion. In case of a routine audit under subsection (1) of section 25, the provisions of section 38 or 38A are not attracted. On completion of an audit sufficient safeguards have been prescribed by the legislature to ensure that the requirements of due process are complied with.

46. *A plain reading of section 46 shows that the Board as well as the Commissioner are empowered to conduct audit of the record and documents of any person registered under the Act of 2005 once a year after giving advance notice in writing. The requirement of giving advance notice in writing obviously includes giving reasons for the selection of a person for audit. This power, if exercised by the Commissioner, is not dependent on a pre-selection to be made by the Board under section 42B. However, the notice in writing required to be given in advance under section 46 has to give reasons, and thus the principles already discussed in the context of section 177 of the Ordinance of 2001 or section 25 of the Act of 1990 shall apply.*

19. From the excerpts cited above it emerges that the opinion required to be formed by the Commissioner for selecting a taxpayer for audit cannot be based on suspicion or conjecture and the Commissioner's power to select a taxpayer for audit is subject to a duty to furnish reasons. And that the focus of section 177 is upon ensuring that the process for selection of audit manifests transparency, fairness and neutrality on part of the Commissioner. That exercise of discretion would not be deemed to be reasonable if it takes into account irrelevant considerations and disregards relevant considerations. And further that the power of the Commissioner to select a taxpayer under section 177(1) is independent of the power of

the FBR to select a taxpayer for audit under section 214C. The dicta of the court requiring the Commissioner in question to provide taxpayers with hearing and an opportunity to raise their objections against their selection was a consequence of the finding that the Commissioner had not complied with his obligations under section 177(1) by recording reasons and communicating them to the taxpayer selected for audit. But instead of setting aside the audit notices for being in breach of the mandatory requirement of stating reasons for selection for audit, the court chose to direct the Commissioner to afford the taxpayer an opportunity to object to their selection and thereafter pass a reasoned order for purposes of section 177(1) after hearing such taxpayer. In other words, in the facts and circumstances of the case and the history of litigation of the case, instead of setting the impugned audit selection orders at naught, the court held that the requirement of 177(1) would be complied with if the Commissioner provided the petitioners a hearing and then passed a reasoned order after taking into account their objections to their audit selection. What the Court did not do or declare was that the taxpayer has a statutory right of hearing under section 177(1) and that the Commissioner could only proceed with audit after affording the taxpayer an opportunity to raise objections against its selection for audit and after addressing such objections through a reasoned order. It was reiterated by the Court that in construing a tax statute, nothing is to be read into the tax statute. And consequently, it is not conceivable that the Court after having reiterated such settled principle of statutory interpretation, read into section 177 the taxpayer's right to have his objections against

selection for audit adjudicated after an adjudicatory hearing, when the legislature in its wisdom has not provided for the same.

20. The question of purpose of an audit has also been enumerated in various judgments. The following was held in **The Federal Board of Revenue Versus Chenone Stores Ltd. (2018 PTD 208)** by the learned Lahore High Court:

23...The concept of audit, as being internationally accepted, has traveled beyond mere verification of correct reporting by taxpayer and raising revenue. Besides creating deterrence by punishing the defaulting taxpayer, an effective audit program pinpoints non-compliant trends; defects in system, ambiguities in practice and the law. On the basis of gathered information and intelligence from an effective audit, and its publication, future Tax Administration can be reshaped; necessary steps can be taken to suggest curative legislation and clarifications of ambiguous practices. The results achieved from effective audit program may help to improve risk management techniques and determine 'Parameters' for future selection of high risk cases for audit.

21. It was held by the learned Sindh High Court in **Shahnawaz (Pvt.) Ltd. Versus Pakistan through the Secretary Ministry of Finance Government of Pakistan, Islamabad (2011 PTD 1558)** that each tax year is a separate unit of assessment and an audit must be undertaken in relation to individual tax year. The learned Sindh High Court took into account the contention of the petitioner under section 177 of the Ordinance of 2001 in the following words:

8...Thus, the power to audit the income tax affairs of the taxpayer has been conferred so that, notwithstanding the transmutation of the return into an assessment order, there is some mechanism whereby it can be ensured that all income that should have been brought to tax has in fact been taxed. The legislative intent behind section 120 is clearly that the taxpayer is to be trusted, but that trust, apparently, is to go only so far, and no further. Acceptance, at face value, of whatever the taxpayer says (section

120) is balanced by, and against, the power to conduct an intrusive examination of his income tax affairs (section 177), and resolving the inherent tension between these two sections is an ongoing exercise in interpretation that has required the attention of the courts, and continues to do so. Both sections 120 and 177 are integral to the scheme of the 2001 Ordinance, and closely interlinked. While these petitions are, strictly speaking, concerned with only the manner in which a taxpayer can be selected for audit, it is clear that once a person has been lawfully and properly selected, the Department is entitled to comprehensively examine the income tax affairs of the taxpayer by carrying out a complete and robust audit.

It was further held that there is no scope for ordering a composite audit under the Ordinance of 2001 and the Sales Tax Act, as notwithstanding the fact that the said statutes are administered by the FBR, provisions for audit provided under each statute are separate provisions and each statute is to be governed in accordance with its own scheme. The relevant part of the said judgment is reproduced below:

23...The concerned authority under each law has to apply its mind independently to the relevant statutory provisions in order to determine whether, and if so how, an audit is to be called under the concerned law, and how a person is to be selected for such an audit. It is also significant that while section 207 expressly recognizes the Board as the authority at the apex of the income tax authorities, section 30 does not, as such, recognize the Board as part of the sales tax authorities. Furthermore, while the Board has the power to call for an audit under both sections 177 and 214C (in the manner as explained above), it has only the power to call for a "special audit" under section 32A of the 1990 Act, and no such power at all under section 25 thereof. The Board cannot simply therefore apply the provisions of one law to the other, and direct that the taxpayers selected for audit under the 2001 Ordinance by way of computer ballot shall also be called for a sales tax audit or vice versa. This last point

also has another aspect. Even assuming for the moment that a computer ballot could be held under both laws for selecting persons for audit, a combined selection under one ballot would still be unlawful. The reason is that if ballots were held separately under the two laws, it is quite possible that a person could be selected under one, but not the other. The combined ballot exposes a person simultaneously to the "double jeopardy" of an audit of both sales tax affairs as well as income tax affairs, for which there does not appear to be any warrant in law.

22. It was held by the august Supreme Court in **Commissioner of Inland Revenue, Sialkot Versus Allah Din Steel and Rolling Mills (2018 SCMR 1328)** which was a leave refusing order that mere selection for audit did not constitute an actionable injury. It was reiterated that where the letter of law was clear, unambiguous and explicit there was no room to interpret it in a manner that expanded or shrunk its scope, meaning and tenor. The august Supreme Court held that under section 177(1) the Commissioner was under an obligation to give reasons for selecting a taxpayer for audit and it also recognized the possible deleterious effect of audit on a business in the following terms:

16...In terms of section 177 of the Ordinance, the Commissioner can call for the record or documents for conducting the audit of the tax affairs of a person, provided he furnishes reasons to do so. Such reasons must be communicated to the Taxpayer. He can also seek explanations from the Taxpayer on issues raised during the audit in terms of section 177 of the Ordinance. It is only if he is convinced that the explanation furnished by the Taxpayer is not satisfactory, he may proceed to amend the assessment under section 122 of the Ordinance, after giving the Taxpayer an opportunity to defend him.

18... While the power of the Board to conduct an audit cannot be denied, it is equally important that a Taxpayer should not be allowed to be pestered and dragged indefinitely through an

unending process of scrutiny and audit of his accounts. This can have negative and disastrous effects on an ongoing and running business. We are therefore unable to agree with the argument of the learned counsel for the Tax Department that the question of time for completion of the audit can be left open ended and the Department can take as much time as it wants to complete the audit.

21. The basic requirement for any scheme of self-assessment and audit is to provide a system of checks and balances and ensure that the Taxpayer in whom the system reposes confidence acts justly, fairly and transparently. At the same time upon selection he must be dealt with in an evenhanded, impartial and transparent manner where-under he shall be granted ample opportunity to justify, substantiate and defend the information provided in tax returns that he voluntarily filed.

The august Supreme Court also explained how section 177 read together with section 120 provided for requisite checks and balances under the Ordinance of 2001.

23. What emerges from the case law is that section 177(1) provides no right to a taxpayer to have its objections on selection for audit adjudicated in a hearing before commencement of such audit. The power of Commissioner to select a taxpayer for audit is independent of the power vested in the FBR to select a taxpayer for such audit under section 214C. The object of audit proceedings under section 177 and under section 214C are also different. Under section 177(1) the Commissioner is focused on the sanctity and correctness of an assessment order deemed to have been passed under section 120 of the Ordinance of 2001 upon filing of a self-assessed tax return, and consequently section 177 provides the Commissioner with a tool to take corrective action if he has reasonable grounds to believe that income of a taxpayer has escaped taxation and scrutiny of books and

accounts of the taxpayer during audit proceedings bear out the grounds on the basis of which an audit was initiated by the Commissioner. The object of powers vested in the FBR to order an audit under section 214C is wider as the FBR is endowed with the responsibility to administer the tax regime. It is for the FBR to, *inter alia*, evaluate the efficacy of the tax regime, the success of the tax policy in collecting tax revenue due from taxpayers, ensure that taxpayers are not being subjected to harassment by officials of the tax department on the one hand and that taxpayers are being held liable to discharge their due tax liability in accordance with law on the other. It is in this larger context that audit selection powers have been vested in the FBR under section 214C of the Ordinance of 2001. Under section 214C the criteria for selection of audit are objective or random. The said provision enables the FBR to conduct random or parametric audit. In exercising its power, the FBR cannot be focused on any particular taxpayer. The tax policy, as adopted and published by FBR for recent years, reflects that FBR has chosen to adopt a risk-based approach for selecting taxpayers for audit in order to focus its limited resources on such class of taxpayers who are more likely to be in breach of their obligations under the Ordinance of 2001.

24. What neither section 214C of the Ordinance of 2001 envisages nor the tax policies promulgated by the FBR, is sectoral audits i.e. audit of all taxpayers belonging to a certain sector or industry. Such approach to audit is not risk-based and would defeat the self-declared object of FBR's audit policy which is meant to exclude all taxpayers likely to have complied with their obligations under the Ordinance of 2001. We however need not discuss the scope of section

214C any further. FBR's audit selection powers under section 214C are not in question before this Court. The purpose of above discussion was merely to highlight that the object of vesting audit selection powers in the Commissioner under section 177(1) of the Ordinance of 2001 are different from the object of vesting audit selection powers in the FBR under section 214C. The exercise of powers by the Commissioner under section 177(1) will always be on a subjective basis in view of an individual taxpayer's returns and history of compliance or non-compliance with provisions of the Ordinance of 2001, as opposed to the exercise of audit selection powers by the FBR under section 214C, meant to be exercised on an objective basis for larger policy purposes.

25. What is clear from the scheme of the Ordinance of 2001, as it now exists, is that FBR has independent power to select taxpayers for audit, which is not contingent upon or correlated with the exercise of audit selection powers by the Commissioner under section 177(1) and vice versa. What FBR cannot do is exercise its powers under sections 206, 213 and 214 of the Ordinance of 2001 in a manner that controls the exercise of discretionary power vested in the Commissioner under section 177(1) of the Ordinance of 2001. Section 206 endows FBR with powers to interpret provisions of the Ordinance and issue circulars for such purpose to provide guidance and directions and such directions are binding on tax authorities. But the power to issue circulars in order to interpret provisions of the Ordinance cannot be employed by FBR to direct the Commissioner to exercise his discretionary authority under section 177(1) to produce certain consequences in relation to individual taxpayers as deemed desirable by the FBR. Likewise, FBR can also not exercise its authority under

sections 213 and 214 of the Ordinance of 2001, under the garb of providing guidance, by issuing directions to Commissioners for purposes of section 177(1) in such manner that it controls or fetters the discretionary audit selection authority vested in the Commissioner under section 177(1). It is settled law that when the legislature vests in a public authority the discretion to reach certain decision, it is for such authority to exercise the power vested by law on the basis of relevant considerations and not for any other authority to usurp such power or control the outcome of such discretionary authority. It is a settled principle of administrative law that discretion vested in an authority by law cannot be fettered and that the discretion is to be exercised by the authority it is vested in, in a just, fair and reasonable manner, and that the exercise of discretion for extraneous considerations amounts to unlawful exercise of such authority. In view of the provisions of the Ordinance of 2001, FBR is vested with no authority or jurisdiction under section 206 to control the discretion vested in the Commissioner under section 177(1) of the Ordinance of 2001.

26. The scheme of the Ordinance of 2001 together with the scheme of the Sales Tax Act, 1990 does not provide for a composite audit of a taxpayer simultaneously, as has also been held by the learned Sindh High Court in **Shahnawaz (Pvt.) Ltd. Versus Pakistan through the Secretary Ministry of Finance Government of Pakistan, Islamabad (2011 PTD 1558)**

27. The issuance of a circular by FBR in exercise of its authority under section 206, as has admittedly been done in relation to Oil Marketing Companies by letter dated 10.03.2021, by directing the

Commissioner to initiate audit of oil marketing companies in exercise of Commissioner's power under section 177(1) is a breach of the provision of the Ordinance of 2001. The FBR would have been within its right to exercise its powers under section 214C in the manner provided therein. But to the extent that it could not exercise its powers under 214C in a subjective manner identifying certain sectors within which taxpayers were to be audited, it could not force the Commissioners to exercise their independent audit selection powers under section 177(1) to achieve such end. It is a settled principle of law that what cannot be done directly cannot be done indirectly either. The exercise of authority by the Commissioner in such manner is also in breach of the scheme of audit as enumerated above. It has already been explained that the purpose for which audit powers have been vested in the FBR is different from the purpose for which such powers have been vested in the Commissioner under section 177(1). The FBR could exercise its audit powers on an objective basis under Section 214C in the manner prescribed, but could not force the hand of the Commissioners to exercise their subjective powers under section 177(1) to trigger the audit of taxpayers effectively selected by the FBR. It has been admitted that notices to some petitioners who are oil marketing companies were issued by the Commissioner under section 177(1) in view of the circular issued by the FBR. The exercise of authority by the Commissioner in such manner is based on an extraneous consideration not contemplated by section 177(1). The fact that the Commissioner, in compliance with the direction of FBR, selected certain taxpayers for audit and then documented reasons for purposes of section 177(1) establishes that such taxpayers were not

selected after independent application of mind by the Commissioner for reasons that can be deemed reasonable for purposes of section 177(1). In view of the aforesaid, the audit selection notices issued under section 177(1) in compliance with the circulars issued by FBR under section 206 are found to be based on an extraneous consideration, and such exercise of discretion controlled and directed by the FBR suffers from legal infirmity.

28. With regard to the sectoral audit, the objection to the maintainability of the petitions is also devoid of force. The sectoral audit letters issued by the FBR mandating Commissioners to exercise authority under section 177(1) constitute a void order as they amounted to the usurpation of power, vested in the Commissioners, unwarranted by law, and are therefore, a nullity. As FBR is devoid of authority to direct Commissioners as to how to exercise discretionary authority under section 117(1) in relation to select taxpayers, it did not have subject matter jurisdiction to issue such orders. (With regard to the test for void orders and their effect, reliance is placed on **Chief Settlements Commissioners, Lahore Vs. Raja Muhammad Fazil Khan and others (PLD 1975 SC 331)**, **The Chairman, District Screening Committee, Lahore and another Vs. Sharif Ahmed Hashmi (PLD 1976 SC 258)** and **Sarosh Haider Vs. Muhammad Javed Chundirgar (PLD 2014 SC 338)**). The august Supreme Court in **Commissioner of Inland Revenue, Sialkot Versus Allah Din Steel and Rolling Mills (2018 SCMR 1328)** has held that selection for audit does not result in an actionable injury in the context of the case before it. But the august Supreme Court has not held that even if the Commissioner exercises authority in breach of requirements of

section 177(1), such action would be protected as audit doesn't of itself cause an actionable injury. The august Supreme Court in **Allah Din Steel and Rolling Mills** has recognized the fact that selection of a business for audit and its prolonged entanglement with the process could have deleterious consequences for a business. Further, a taxpayer has a right guaranteed by Article 4 of the Constitution to be treated in accordance with law. And every public office holder, including a Commissioner discharging authority under the Ordinance of 2001, is under an obligation to act in accordance with law. To the extent that the exercise of discretion by the Commissioner is for extraneous reasons and not in accordance with law, which affects the tax affairs of a taxpayer, such taxpayer has a right to impugn the Commissioner's action. The Ordinance of 2001 does not provide for a statutory remedy against a taxpayer's illegal selection for audit. The remedy proposed by the learned counsel for FBR under section 7 of the FBR Act in the present context is illusory. Given that exercise of authority by the Commissioner to commence a sectoral audit, found by this Court to be illegal, is the consequence of a circular issued by the FBR itself, FBR cannot be a judge in its own cause.

29. The controversy in relation to notices under sections 25 of the Sales Tax Act and section 46 of the Federal Excise Act is much narrower. The arguments before this Court as articulated by the learned counsels for the petitioners were twofold. One, that the procurement of record under section 25(1) of the Sales Tax Act and selection of audit by the Commissioner under section 25(2) is a two-stage process and selection of audit under section 25(2) is based on application of mind after scrutiny of record procured by the

Commissioner under section 25(1). The second submission is that the Commissioner is under an obligation under section 25(1) to record reasons before calling for a taxpayer's record.

30. Section 25(1) empowers the Commissioner to call for record as and when required given that this is discretionary authority vested in the Commissioner by statute. The Commissioner is under an obligation to record reasons for exercise of such discretionary authority in view of section 24A of the General Clauses Act. Such exercise of authority must be just, fair and reasonable, on the basis of relevant considerations and not in pursuit of any extraneous considerations. This has also been held by the learned Sindh High Court most recently in **Dewan Sugar Mills Vs. Federation of Pakistan** (Suit No. 850/2021 decided on 09.08.2021) and the learned Lahore High Court in **Raza Motor Industries Vs. Federation of Pakistan** (W.P No. 37251/2021 decided on 14.06.2021). To the extent of the Commissioner's obligations prior to procuring a taxpayer's record under section 25(1), there is nothing to gainsay that the exercise of such discretionary authority by the Commissioner must not be arbitrary and that the exercise of authority would be subject to judicial review if found to have been triggered by extraneous considerations.

31. The second contention of the petitioners that selection of audit is a two-stage process and selection under section 25(2) is contingent on scrutiny of record procured under section 25(1) appears to this Court to be counter-intuitive. Learned counsel for the petitioners have relied on **Indus Motor Company Vs. Federation of Pakistan** (2020(121) Tax 8 Karachi) wherein the learned Sindh High Court has held that notice for selection of audit under section

25(2) and the notice of production of record under section 25(1) could not be issued simultaneously, and that it was only on the basis of record procured and after assigning reasons that selection for audit may be made under section 25(2). This Court has been unable to persuade itself that section 25 of the Sales Tax Act contemplates a two-stage audit selection process. Section 25(1) creates a power vested in the Commissioner to summon the record maintained by the registered person for purposes of Sales Tax Act. The Commissioner is already in possession of returns filed by the registered person on the basis of self-assessment. Thus, prior to exercising his discretionary authority under section 25(1) to summon record, the Commissioner must state that there are reasonable grounds to conclude that self-assessed returns are not an accurate reflection of the registered person's tax liability and consequently there is need to audit the record maintained by the taxpayer in order to ascertain whether there is need to pass any reassessment order. Consequently, the determination of existence of reasonable grounds to summon the record for purposes of audit under section 25(1) is a prerequisite for exercise of such authority under section 25(1). It is inconceivable as to what would constitute reasonable grounds for exercise of section 25(1) power, other than the Commissioner's reasonable belief that the return filed by the registered person is not accurate. Further, in terms of determining whether or not to select a registered person for audit, nothing would remain to be done once the Commissioner has already procured the relevant record and scrutinized it. The scrutiny of record to determine whether or not a return is accurate is what the audit entails. In the event that determination of reasonable grounds for

summoning record is a prerequisite for the issuance of notice under section 25(1), what would remain to be done by the Commissioner at stage two after having scrutinized the record?

32. Further, the language of section 25(2) also does not use the word selection. The power to select a person for audit is implicit in sections 25(1) and 25(2) read together. It is prior to the issuance of notice for procuring record of the taxpayer for purposes of audit that reasonable grounds must exist empowering the Commissioner to exercise his 25(1) powers. Section 25(2) then provides that the audit is to be conducted on the basis of the record procured by in exercise of powers under section 25(1). In view of such reading of section 25 of the Sales Tax Act, this Court is not convinced that the action of the Commissioner in simultaneously calling for the record of a registered person under section 25(1), while also recording reasons for selection of such registered person for audit suffers from legal infirmity. The proviso to section 25 of Sales Tax Act states that if sufficient evidence of tax fraud or evasion by the registered person is available, the Commissioner can order an inquiry or investigation under section 38. This seems to be the subjective purpose of the process prescribed under section 25: to determine whether the audit reveals basis to exercise authority under section 11 on the one hand or section 38 of the Sales Tax Act on the other.

33. When the Commissioner calls for record to be produced under section 25(1), it amounts to selection of the registered person for audit. Based on the record produced, the Commissioner undertakes the audit and produces the audit report after obtaining the registered

person's explanation. With this the audit comes to a close, and the Commissioner can pass an order under section 11 of the Sales Tax Act if the audit report reflects that grounds for such order are made out. The audit scheme under the Sales Tax Act and the Federal Excise Act is also a three-stage process. At stage one the registered person can be obliged to provide relevant record upon selection for audit by the Commissioner on the basis of reasonable grounds communicated to such registered person. At stage two the audit official is to seek explanation from the registered person in relation to audit-related concerns prior to finalization of the audit report. And at stage three the Commissioner may invoke section 11 of the Sales Tax Act and section 14 of the Federal Excise Act to pass an appropriate order if the audit report provides a basis for exercise of such authority. The authority vested in the Commissioner under section 25 of the Sales Tax Act for selection of audit is independent of the authority vested in the FBR to conduct audit under section 72B. Likewise, under the Federal Excise Act the Commissioner is vested with the authority for audit selection under section 46 which is independent of the authority vested in the FBR under section 42B.

34. Thus, to the extent that the Commissioner has exercised authority to select a taxpayer for audit in view of any directive issued by the FBR, whether under the Ordinance of 2001, Sales Tax Act or Federal Excise Act, such exercise of discretionary authority by the Commissioner is driven by an extraneous consideration and is not sustainable in the eyes of law. However, to the extent that the Commissioner has issued a notice under section 177(1) of the Ordinance of 2001 or section 25(1) of the Sales Tax Act, which

documents reasonable grounds for selection of the taxpayer or registered person for audit and directed such person to produce record, such notice suffers from no infirmity, either on the basis that exercise of audit-selection authority by the Commissioner is contingent on exercise of audit selection authority by FBR under the Ordinance of 2001 and the Sales Tax Act, or that selection for audit has not been made in a two-stage process after procurement of record under section 25(1) of the Sales Tax Act and its scrutiny by the Commissioner.

35. For the aforementioned reasons it is declared as follows:

(i) Every citizen has a right to be treated in accordance with law and a public official has an obligation to discharge the authority vested in him in accordance with law as mandated by Article 4 of the Constitution. A citizen on the receiving end of exercise of authority not backed by law has a right to have such exercise of authority subjected to the judicial review powers of a High Court under Article 199 of the Constitution, subject to the satisfaction of other requirements of maintainability prescribed therein.

(ii) FBR is vested with no authority under section 206 read with sections 213 and 214 of the Ordinance of 2001 or any provision of the Sales Tax Act or the Federal Excise Act to issue a directive or circular to Commissioners directing such Commissioners to undertake sectoral audits or otherwise bind them in terms of how they are to exercise their discretionary authority under section 177(1) of the Ordinance of 2001 or section 25(1) of the Sales Tax Act or section 46 of the Federal Excise Act. Any such directive is devoid of justification and a nullity. Thus, an audit selection notice issued by the Commissioner under section 177(1) to an Oil Marketing Company on the basis of the sectoral audit

directive issued by FBR is tantamount to a notice issued for extraneous reasons and is liable to be set-aside.

(iii) Audit proceedings initiated on the basis of a directive issued by the FBR having been declared to be void would also be devoid of lawful authority and would cease. This would, however, not inhibit the Commissioner from independently exercising his/her authority under section 177 of the Ordinance of 2001 on the basis of reasons that satisfy the requirements of section 177.

24. For the aforesaid reasons, Writ Petitions No. 1499 to 1507, 1600, 1601, 1603, 1604, 1605 and 1606 of 2021 are **allowed** and the notices impugned therein are set-aside. The instant petition and the petitions listed in the Schedule, other than the ones mentioned hereinabove, are **dismissed**.

(BABAR SATTAR)
JUDGE

Announced in the open Court on 08.11.2021.

JUDGE

Approved for reporting.

Saeed.

SCHEDULE

Serial No.	CASE NO./YEAR	TITLE
1.	WP. 272-2021	M/s Pakistan Tobacco Company Ltd. Vs. FOP etc.
2.	WP. No. 1052-2021	Best way Cement Ltd Vs. CIR
3.	WP. No. 1168-2021	M/s Force Batteries Pvt. Vs. CIR
4.	WP. No. 1169-2021	M/s Force Batteries Pvt. Vs. CIR
5.	WP. No. 1170-2021	M/s Force Batteries Pvt. Vs. CIR
6.	WP. No. 1171-2021	M/s Force Batteries Pvt. Vs. CIR
7.	WP. 1172-2021	M/s Force Batteries Pvt. Vs. CIR
8.	WP. 1173-2021	M/s Force Batteries Pvt. Vs. CIR
9.	WP. 1174-2021	M/s Force Batteries Pvt. Vs. CIR
10.	WP. No. 1175-2021	M/s Force Batteries Pvt. Vs. CIR
11.	WP. 1265-2021	Fauji Fertilizer Company Pvt Ltd Vs. FOP etc.
12.	WP. 1266-2021	Fauji Fertilizer Company Pvt Ltd Vs. FOP etc.
13.	WP. 1267-2021	Fauji Fertilizer Company Pvt Ltd Vs. FOP etc.
14.	WP. 1268-2021	Fauji Fertilizer Company Pvt Ltd Vs. FOP etc.
15.	WP. 1269-2021	Fauji Fertilizer Company Pvt Ltd Vs. FOP etc.
16.	WP. 1373-2021	Fauji Cement Company Ltd vs. CIR
17.	WP. 1374-2021	Askari Cement Ltd. vs. CIR
18.	WP. 1391-2021	Askari Cement Ltd. vs. CIR
19.	WP. 1392-2021	Askari Cement Ltd. vs. CIR
20.	WP. 1393-2021	Fauji Cement Ltd. Vs. CIR
21.	WP. 1394-2021	Fauji Cement Ltd. Vs. CIR
22.	WP. 1499-2021	Attock Petroleum Ltd. Vs. Pakistan etc.
23.	WP. 1500-2021	Attock Petroleum Ltd. Vs. Pakistan etc.

24.	WP. 1501-2021	Attock Petroleum Ltd. Vs. Pakistan etc.
25.	WP. 1502-2021	Attock Petroleum Ltd. Vs. Pakistan etc.
26.	WP. 1503-2021	Attock Petroleum Ltd. Vs. Pakistan etc.
27.	WP. 1504-2021	Attock Petroleum Ltd. Vs. Pakistan etc.
28.	WP. 1505-2021	Attock Petroleum Ltd. Vs. Pakistan etc.
29.	WP. 1506-2021	Attock Petroleum Ltd. Vs. Pakistan etc.
30.	WP. 1507-2021	Attock Petroleum Ltd. Vs. Pakistan etc
31.	WP. 1590-2021	M/S SIS Corporation Pvt. Ltd Vs CIR
32.	WP. 1591-2021	M/S Reliance Corporation Pvt. Ltd. Vs CIR
33.	WP. 1592-2021	M/S Reliance Corporation Pvt. Ltd. Vs CIR
34.	WP. 1593-2021	M/S SIS Corporation Pvt. Ltd Vs CIR
35.	WP. 1600-2021	Attock Petroleum Ltd. Vs. Pakistan etc.
36.	WP. 1601-2021	Attock Petroleum Ltd. Vs. Pakistan etc.
37.	WP. 1602-2021	Attock Petroleum Ltd. Vs. Pakistan etc
38.	WP. 1603-2021	Attock Petroleum Ltd. Vs. Pakistan etc
39.	WP. 1604-2021	Attock Petroleum Ltd. Vs. Pakistan etc.
40.	WP. 1605-2021	Attock Petroleum Ltd. Vs. Pakistan etc.
41.	WP. 1606-2021	Attock Petroleum Ltd Vs. Pakistan etc.
42.	WP. 1631-2021	M/s Innaya Technical Solutions Vs. Pakistan etc
43.	WP. 1632-2021	M/s HSC Technologies Pvt. Ltd. Vs. CIR
44.	WP. 1633-2021	M/s HSC Technologies Pvt. Ltd. Vs. CIR
45.	WP. 1635-2021	M/s Trade Grain Pvt. Ltd. Vs. CIR
46.	WP. 1672-2021	M/s Hope Vs. CIR
47.	WP. 2202-2021	M/s Pakistan Tobacco Company Ltd. Vs. FOP
48.	WP. 2237-2021	Attock Petroleum Ltd. Vs. FOP etc.
49.	WP. 2287-2021	Fastoil Pvt. Vs. FOP etc.

50.	WP. 2364-2021	Jadeed Oil Extractions Pvt. Ltd. Vs. FOP, etc.
51.	WP. 2409-2021	3G VAS Pvt Ltd. Vs. FOP etc.
52.	WP. 2547-2021	M/s Rawat Oil & Ghee Mills Pvt. Vs. FOP etc.