

THE HIGH COURT OF SINDH, KARACHI

Suit No. 2415 of 2016

[Saleem Butt v. Pakistan through Secretary Revenue Division & others]

Plaintiff : Saleem Butt through M/s. Ahmed Hussain and Ms. Pooja Kalpana Advocates.

Defendant 1 : Pakistan, through Secretary Revenue Division and ex-officio Chairman Federal Board of Revenue, through Mr. Anwar Kamal, Assistant Attorney General.

Defendant 2 : Nemo

Defendant 3 : Commissioner Inland Revenue through M/s. Syed Mohsin Imam and Aqeel Qureshi, Advocates.

Dates of hearing : 20-01-2021, 22-01-2021, 12-02-2021, 26-02-2021 & 04-03-2021

Date of decision : 31-05-2021

JUDGMENT

Adnan Iqbal Chaudhry J.- By this suit the Plaintiff has challenged notice dated 10-11-2016 issued under section 177(1) of the Income Tax Ordinance, 2001 by the Commissioner Inland Revenue (impugned notice), calling upon the Plaintiff to provide record for audit of his income tax affairs for the tax year 2013. By an earlier Suit No. 1872/2016 the Plaintiff had also challenged a notice issued under section 176(1) of the Income Tax Ordinance, 2001 by the Directorate of Intelligence & Investigation (Inland Revenue), which suit is being decided separately.

2. The impugned notice under section 177(1) of the Income Tax Ordinance, 2001 averred as follows:

“Subject: AUDIT UNDER SECTION 177 OF THE INCOME TAX ORDINANCE, 2001 FOR THE TAX YEAR 2013 - INTIMATION REGARDING.

.....

Your record available with this office has been examined and it has been found necessary to call for further record, documents and books of accounts for examination and conducting audit u/s 177 (1) of the Income Tax Ordinance, 2001 for tax year 2013. The grounds and reasons/risk areas to exercise the powers u/s 177(1) are mentioned below:-

1. In the return of income for the Tax Year 2013, you have declared salary income amounting to Rs.31,160,000/-. As per the Income Tax Return for the Tax Year 2012, the declared salary income was Rs.14,652,500/-. This shows that during a single year, salary has increased by 52.60%. This is quite unusual and requires verification in the light of documentary evidences.

2.

3. As per wealth statement for the period ending 30.06.2012, you have declared following Motor Vehicles:-

.....

However, as per Wealth statement for TY 2013, you have declared:-

.....

The disposal of all the old cars and purchase of new cars requires detailed examination so as to verify the sources for the same alongwith supporting documentary and wealth reconciliation statement.

4. In Tax Year 2012, you had declared commercial Plot No.68, Phase-VI, Defence Housing Authority, Karachi at Rs.550,000/-. However, no such plot has been declared during TY 2013 which means the same has been sold during the year. The sale of the plot and taxability of resultant gain requires examination including verification of actual as well as fair market value.

5.

6. As per wealth statement you have declared other liabilities (Running Finance) at Rs.43,269,021/-as against Rs.23,336,097/- in the Tax Year 2012. This aspect has to be verified through audit to determine application of funds and its tax implication.

7. Examination of wealth statement reveals that you have purchased shares of M/s Fossil Energy of Rs.40,000,000/- which requires examination with supporting documentary evidence to determine sources of investment.

8.

9. In your wealth reconciliation statement capital gain on sale of plot has been declared at Rs.10,141,000/-. This requires verification related to nature and taxability under the Ordinance.

.....

-sd-
Commissioner Inland Revenue"

The Plaintiff did not file a reply to the impugned notice but instead filed the instant suit on 14-11-2016 for a declaration that “section 177 of the Income Tax Ordinance, 2001 and the audit notice u/s 177 dated 10.11.2016 to be *malafide*, completely without jurisdiction, unconstitutional, unlawful, void ab-initio and of no legal effect, while annulling the same.” A consequential relief for injunction was also sought.

3. By a common order dated 12-10-2020 passed in this suit and Suit No. 1872/2016, the Defendants were debarred from written statement. Order dated 06-09-2019 passed in this suit, and common order dated 05-11-2020 passed in this suit and the connected Suit No. 1872/2016 observed that the suit involved legal issues only, and counsel were put on notice to make submissions for determination of the suit at the preliminary stage pursuant to Order XV Rule 3 CPC.

4. With the assistance of learned counsel, following legal issues emerged for determination of the suit:

- (i) Whether section 177(1) of the Income Tax Ordinance, 2001 is *ultra vires* Articles 25 of the Constitution of Pakistan ?
- (ii) Whether section 177 of the Income Tax Ordinance, 2001 militates against the scheme of deemed assessment under section 120 of the Ordinance, hence *ultra vires* the Ordinance ?
- (iii) Whether the impugned audit notice is in continuation of notice dated 09-08-2016 issued by the Directorate General Intelligence & Investigation under section 176 of the Income Tax Ordinance which was without jurisdiction ? If so, to what effect ?
- (iv) Whether the impugned notice is *malafide* and/or discriminatory of the Plaintiff ?
- (v) What should the decree be ?

Since learned counsel stated that were ready to proceed forthwith, arguments were commenced by Mr. Ahmed Hussain, Advocate for the Plaintiff. However, later on Ms. Pooja Kalpana

Advocate stepped in for the Plaintiff due to the illness of Mr. Ahmed Hussain.

Issue No. (i): Whether section 177(1) of the Income Tax Ordinance, 2001 is ultra vires Article 25 of the Constitution of Pakistan ?

5. Sub-section (1) of section 177 of the Income Tax Ordinance, 2001 reads as under:

“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.”

Learned counsel for the Plaintiff submitted that section 177(1) of the Ordinance gave unchecked and arbitrary powers to the Commissioner Inland Revenue to pick and choose any person for initiating audit; hence *ultra vires* Article 25 of the Constitution of Pakistan. Reliance was placed by learned counsel on *Chenone Stores Ltd. v. Federal Board of Revenue* (2012 PTD 1815). On the other hand, learned counsel for the tax department submitted that after the enunciation in *Commissioner of Inland Revenue, Sialkot v. Allah Din Steel and Rolling Mills* (2018 SCMR 1328), the challenge to the *vires* of section 177(1) of the Ordinance was futile. In rebuttal, learned counsel for the Plaintiff submitted that the case of *Allah Din Steel* was not applicable to the facts of this suit as *Allah Din Steel* was only with

regards to selection of audit by random ballot under section 214-C of the Ordinance.

6. Heard the learned counsel and perused the record. The reliance placed by learned counsel for the Plaintiff on *Chenone Stores Ltd. v. Federal Board of Revenue* (2012 PTD 1815) is misplaced. In that case, a learned single judge of the Lahore High Court held that after the insertion of section 214-C in the Income Tax Ordinance, the power to select for audit came to vest in the FBR, and it was only after such selection by the FBR that the Commissioner could exercise the power of audit under section 177 of the Ordinance. It was on that premise that the first proviso to section 177(1) of the Ordinance was struck down as being arbitrary and against due process. However, that judgment was prior to the insertion of the following Explanation clause in section 177 of the Ordinance by the Finance Act, 2013:

“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.”

Thus, after *Chenone Stores* (single Bench), the legislature proceeded to declare that the power of the Commissioner Inland Revenue to audit under section 177 of the Ordinance was independent of the power of the FBR to select for audit under section 214-C of the Ordinance. Thereafter, when *Chenone Stores* came up in an intra-court appeal before a learned Division Bench of the Lahore High Court in *Federal Board of Revenue v. Chenone Stores Ltd.* (2018 PTD 208), it was held :

“22. After the clarification and declaration of Legislative Policy that Commissioner's power to select and conduct audit are independent of FBR's power to select for audit, the binding force of the judgment in *Chenone Stores' Case* has effectively been obliterated.

The first proviso to section 177(1) was struck down with an observation that ‘it equips the Commissioner with the arbitrary

power to pick and choose any taxpayer for audit', which shows, itself, that the discretion given is capable of being misused. The provision of law cannot said to be ex facie discriminatory merely because the discretionary power given by it, can be used arbitrarily. To be dealt in accordance with law, due process, fair trial and being treated indiscriminately are fundamental rights enforceable through Court by invoking extraordinary Constitutional jurisdiction. The act of picking and choosing arbitrarily can always be taken cognizance of by Courts and declared to be in violation of fundamental right, but the law cannot be declared ultra vires for being misused, as has been held in Shaukat Ali Mian's case. In Imrana Tiwana's case, besides endorsing this view, it is held that 'Courts must prefer the interpretation which favours the validity' and that 'reasonable doubt must be resolved in favour of the statute being valid'."

7. A challenge to the *vires* of section 177 of the Income Tax Ordinance, 2001 on the touchstone of Articles 10A, 18 and 25 of the Constitution of Pakistan was also turned down by a Full Bench of the Islamabad High Court in *Pakistan Telecommunication Company Ltd. v. Federation of Pakistan* (2016 PTD 1484) by observing additionally that the scope of the power of the Commissioner under section 177 of the Ordinance was circumscribed by the checks and limitations in-built in section 177 of the Ordinance.

8. Though the case of *Commissioner of Inland Revenue, Sialkot v. Allah Din Steel and Rolling Mills* (2018 SCMR 1328) dealt with a question to selection of audit by random ballot under section 214-C of the Income Tax Ordinance, however in addressing said question the Honourable Supreme Court also made the following observations which are applicable to an audit also under section 177 to the Ordinance:

"10. The power to select for audit through random or parametric balloting is provided under the law. We have repeatedly held that mere selection for audit does not cause an actionable injury to the Taxpayer. The reason and objective for conducting an audit under a scheme of self assessment, which is the regime provided by the Ordinance, is to check the accuracy, truthfulness and veracity of the returns filed by the Taxpayers. These are required to be supported by the requisite documentation and records. When a Taxpayer is selected for audit, he is called upon to explain his case

where explanation is required and furnish the documents which support such explanation. In case, he satisfies the authorities that the tax returns submitted by him are truthful, reliable and supported by the necessary documentation, it may not culminate in further proceedings or in an amendment in the returns and enhanced tax liability may not be the outcome. This is so because mere selection for audit by itself is not a complete process. This is the beginning of a process which may or may not culminate in revision of assessment, enhanced tax liability or other adverse legal consequences. It may also be noted that once a Taxpayer is selected for audit and till such audit is completed the Taxpayer is provided ample and multiple opportunities at every step to defend his position, support his returns and offer explanations for the information provided and entries made in the tax returns. Further, even if a discrepancy is discovered he is provided yet another opportunity to explain his position before his assessment is revised. It must therefore be emphasized that the process of audit is in essence an exercise of re-verification of the truthfulness, accuracy and veracity of the returns filed by a Taxpayer in a regime of self assessment where the State reposes confidence in the Taxpayer, gives him a freehand and provides him the option to undertake his own assessment of the quantum of tax that he is liable to pay. His return automatically takes the form of a final assessment order unless it is reopened and re-examined in the circumstances provided in the law itself.

.....

16. A perusal of the statutory landscape makes it clear that the provisions of sections 177 and 214 of the Ordinance; section 25 of the Act, 1990 and section 46 of the Act, 2005 provide a mechanism and roadmap which is required to be followed by the Taxation Officer/Auditor. 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. We are therefore of the view that the statutory framework together with the overarching umbrella of constitutional guarantees furnish adequate and sufficient safeguards to the Taxpayer where there is a possibility of overstepping by the Tax authorities."

9. The ratio of the cases of *Chenone Stores (Division Bench)*, *Pakistan Telecommunication Company* and *Allah Din Steel* discussed above is that, given the mechanism in-built in section 177 of the Income Tax

Ordinance, which includes the providing of reasons in writing to the taxpayer, the power conferred on the Commissioner Inland Revenue to call for record under section 177(1) of the Ordinance, does not by itself offend Article 25 of the Constitution. The question then, whether such power has been used unlawfully, is different, and one that may vary with the circumstances of each case.

10. In *Lahore Development Authority v. Imrana Tiwana* (2015 SCMR 1739), while observing that the power to strike down or declare a legislative enactment void has to be exercised with the greatest care and caution, the Supreme Court summarized as follows the rules which must be applied before declaring laws to be unconstitutional¹ :

I. There is a presumption in favour of constitutionality and a law must not be declared unconstitutional unless the statute is placed next to the Constitution and no way can be found in reconciling the two;

II. Where more than one interpretation is possible, one of which would make the law valid and the other void, the Court must prefer the interpretation which favours validity;

III. A statute must never be declared unconstitutional unless its invalidity is beyond reasonable doubt. A reasonable doubt must be resolved in favour of the statute being valid;

IV. If a case can be decided on other or narrower grounds, the Court will abstain from deciding the constitutional question;

V. The Court will not decide a larger constitutional question than is necessary for the determination of the case;

VI. The Court will not declare a statute unconstitutional on the ground that it violates the spirit of the Constitution unless it also violates the letter of the Constitution;

VII. The Court is not concerned with the wisdom or prudence of the legislation but only with its constitutionality;

VIII. The Court will not strike down statutes on principles of republican or democratic government unless those principles are placed beyond legislative encroachment by the Constitution."

Imrana Tiwana went on to reiterate :

¹ Also reiterated in *Sui Southern Gas Company Ltd. v. Federation of Pakistan* (2018 SCMR 802).

“71. This Court has on several occasions held that where a statute is not ex-facie repugnant to Fundamental Rights but is capable of being so administered it cannot be struck down unless the party challenging it can prove that it has been actually so administered”.

Therefore, it was never sufficient for the Plaintiff to argue that section 177(1) of the Income Tax Ordinance was *ultra vires* Article 25 of the Constitution, and the Plaintiff had also to demonstrate that the powers exercised by the Commissioner Inland Revenue under said provision had actually lead to an infringement of the Plaintiff's Fundamental Right under Article 25 of the Constitution. Whether that has been done by the Plaintiff or not, is dealt with under Issue No. (iv) *infra*.

The upshot is that the challenge to the *vires* of section 177(1) of the Income Tax Ordinance on the ground that it generally offends Article 25 of the Constitution, cannot succeed. Issue No.(i) is answered in the negative.

Issue No. (ii): Whether section 177 of the Income Tax Ordinance, 2001 militates against the scheme of deemed assessment under section 120 of the Ordinance, hence ultra vires the Ordinance ?

11. Learned counsel for the Plaintiff had submitted that section 177(1) of the Income Tax Ordinance for calling record for conducting audit could not be invoked when no proceedings were pending against the Plaintiff under section 122 of the Ordinance for amendment of assessment, and thus the impugned audit notice militates against the concept of deemed assessment under section 120 of the Ordinance. Suffice to say that such misconception has by now been laid to rest by the Supreme Court in the case of *Commissioner Inland Revenue Zone-I, RTO, Rawalpindi v. Khan Filling CNG Station, Rawalpindi* (2017 SCMR 1414) as follows:

“Thus the Commissioner, Inland Revenue by virtue of and in exercise of the powers contained in sections 120(1A), 121, 122(1)(5A), 176 and 177 of the Ordinance can initiate the proceedings for investigating the income tax affairs of a person notwithstanding the fact that such return of income by virtue of section 120(1) of the

Ordinance was taken as an assessment made and assessment order issued by the Commissioner, Inland Revenue. The deemed assessment order after its amendment with conscious application of mind loses its legal effect in terms of subsection (10) of section 177 of the Ordinance.”

Therefore, issue No. (ii) is answered in the negative.

Issue No. (iii): Whether the impugned audit notice is in continuation of notice dated 09-08-2016 issued by the Directorate General Intelligence & Investigation under section 176 of the Income Tax Ordinance which was without jurisdiction ? If so, to what effect ?

12. As noted at the outset, the prior notice dated 09-08-2016 issued by the Directorate General Intelligence & Investigation under section 176 of the Income Tax Ordinance, was challenged by the Plaintiff in Suit No. 1872/2016. In that suit it has been held that said notice was within the jurisdiction of the Directorate General Intelligence & Investigation. Therefore, the above Issue No. (iii) has become redundant.

Issue No. (iv): Whether the impugned notice is malafide and/or discriminatory of the Plaintiff ?

13. Learned counsel for the Plaintiff submitted that the impugned audit notice was *malafide in fact*, which is established by the fact that the Commissioner Inland Revenue issued the impugned audit notice knowing fully well that a status quo order dated 23-08-2016 was operating in the Suit No. 1872/2016. On the other hand, learned counsel for the department submitted that the allegation of *malafides* was baseless when it is not even alleged that the Commissioner Inland Revenue had any axe to grind against the Plaintiff.

Apparently, Suit No. 1872/2016 was filed by the Plaintiff to primarily challenge the jurisdiction of the Directorate General Intelligence & Investigation to call for record under section 176 of the Income Tax Ordinance. Therefore, in the scope of that suit, the status quo order dated 23-08-2016 passed therein had at best restrained the Directorate General Intelligence & Investigation from proceeding on the notice under section 176 of the Ordinance. On the other hand, the

subsequent notice calling for record under section 177(1) of the Ordinance (impugned notice) is by the Commissioner Inland Revenue, who was not even arrayed as a defendant in Suit No. 1872/2016. It is not the Plaintiff's case that the Commissioner Inland Revenue did not have jurisdiction to issue the latter notice. Nonetheless, it is settled law that a mere allegation of *malafides* is not enough to dislodge the presumption of correctness attached to official acts, and before the allegation of *malafides in fact* can be allowed to be proved, such *malafides* have to be pleaded with particulars.² Apart from a bald averment of *malafides*, the plaint does not give any particulars. Resultantly, the allegation of *malafides* requires no probe.

14. Learned counsel for the Plaintiff had then submitted that the impugned audit notice is discriminatory of the Plaintiff and offends his Fundamental Right of Article 25 of the Constitution. However, that submission would have been worthwhile had the impugned notice not assigned any reasons. The impugned notice, reproduced in para 2 above, clearly gives plausible reasons for asking for documents under section 177(1) of the Income Tax Ordinance. The impugned notice was never replied by the Plaintiff. The plaint also does not attack the grounds taken in the impugned notice, nor were such grounds addressed during the course of submissions. Therefore, the Plaintiff had never set-up a case for discrimination.

In view of the foregoing, Issue No.(iv) is also answered in the negative.

Issue No. (v): What should the decree be?

15. Having answered all issues against the Plaintiff, the suit is dismissed along with pending applications.

JUDGE

Karachi:

Dated: 31-05-2021

² Reiterated in *Justice Qazi Faez Isa v. The President of Pakistan* (PLD 2021 SC 1).