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CONTENTS

- 531 Understanding tax morale of SMEs: A qualitative study
Recep Yücedođru and John Hasseldine
- 567 Business process management as a tax risk identification and
management method
Evadne Bronkhorst and Elze Leask
- 587 Effects of tax reform on average personal income tax burden and
tax progressivity in Germany under the particular consideration
of bracket creep
Chang Woon Nam and Christoph Zeiner
- 601 The implementation of informal sector taxation: Evidence from
selected African countries
Godwin Dube and Daniela Casale
- 624 The UK general anti abuse rule: Lessons for Australia?
Benjamin Kujinga
- 650 Are Australians under or over confident when it comes to tax
literacy, and why does it matter?
Toni Chardon, Brett Freudenberg and Mark Brimble
- 683 Tax policy challenges in an era of political transition: The case
of Egypt
Mahmoud M Abdellatif and Binh Tran-Nam
- 707 Developing a sustainable tax base through a financial transaction
tax: An analysis of suitability for the New Zealand environment
Simoné Pycke, Jagdeep Singh-Ladhar and Howard Davey
- 719 Filling the land tax void: New Zealand standpoint
Ranjana Gupta

CONTENTS CONTINUED

741 Delineating the fiscal borders of Australia's non-profit tax concessions
Natalie Silver, Myles McGregor-Lowndes and Julie-Anne Tarr

766 Does selecting a taxpayer for audit violate civil rights—a critical analysis of the Pakistani High Court's decision?
Najeeb Memon and Christian Lorenz

Does selecting a taxpayer for audit violate civil rights—a critical analysis of the Pakistani High Court’s decision?

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Abstract

This paper deals with taxpayers’ selection for tax audit under the Self Assessment Scheme (SAS). Tax administrations across the world are continuously striving to improve the quality of taxpayer selection for audit. Often, the one who gets selected asks, ‘why me?’ Recently, the Lahore High Court (LHC) in Pakistan has held that selection for audit by field officers, being discriminatory, violates the civil rights enshrined in the Constitution of Pakistan, such as equal protection under law for all citizens. This paper reviews international best practices and finds that tax agencies, through collaboration of central and field officers, use both objective and subjective criteria in the selection. Another finding is that tax agencies in various jurisdictions are given leverage to select any taxpayer for audit and the courts there do not hold such selections unconstitutional. A critical analysis of the LHC decision in this paper finds that it suffers from legal and rational fallacies because it has ignored the autonomy given by the superior courts of various jurisdictions for discriminating citizens in taxation if that has a reasonable basis and helps in securing tax objectives such as redistribution of income.

Keywords: Taxpayer audit, Selection quality, Civil rights, Self Assessment Scheme (SAS)

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1. INTRODUCTION

Since the introduction of the Self Assessment Scheme (SAS) in income tax, the process of taxpayer selection for audit has been of central importance and received much attention from policy makers in designing tax compliance management.³ Right selections help in detecting evading taxpayers and consequently deter non-compliance. The goal of picking taxpayers for audit is to reward compliant taxpayers instead of punishing the delinquent ones.⁴

Tax administrations have worked rigorously to improve the quality of selection. Most tax administrations in the world have been statutorily given the liberty to select any case for audit.⁵ Under best practices in this regard, the selection is partly based on the objective criteria emanating from data mining by a central office; and partly on some subjective judgment of case officers. This freedom in the selection and collaboration between central and field formations has provided for better responding to the dynamic business world and changes in taxpayers' behaviour.⁶ However, the individual who is selected for audit often asks, 'why me?' and alleges discrimination.⁷

In terms of similar allegations in Pakistan, the Lahore High Court (LHC) has recently held that a taxpayer's selection for audit by a case officer without fixed statutory selection criteria is discriminatory and violates the constitutional right of equality of citizens. The Pakistani Tax Code, detailed in Part 4 of this paper, empowers the central office and case managers to select any taxpayer for audit. For selection by the latter no criteria is provided in the tax code resulting in allegations of discrimination. The LHC has held that in the presence of power resting with the central office to select on the basis of risk parameters, the parallel authority of the case officers to select without statutory criteria violates the right of equality of citizens. Thus, the LHC expects that legislature should also provide objective criteria for selection by case managers. The LHC decision has ignited crucial debate as to whether a tax statute, which empowers the tax agency to pick any case for tax audit on the basis of subjective criteria, violates the basic civil right of equality enshrined in most state constitutions. This paper attempts to examine this issue and to draw guidelines for tax administration regarding selection of cases for audit.

A critical analysis of the LHC decision finds that the LHC, while suggesting fixed criteria for case managers, has erred in treating case managers and the central office as distinct administrative entities. Case managers and head office are two parts of an administrative body called the Federal Board of Revenue (FBR), which is the sole federal tax administration in the country. Both wings have to work in collaboration to identify risk to tax compliance in respect of one taxpayer or a class of taxpayers. The case managers report to the head office hence they are under control of the head office. The LHC therefore cannot segregate their roles in absolute terms. The LHC lacks

³ OECD, 'Compliance Risk Management: Managing and Improving Tax Compliance' (Forum on Tax Administration Compliance Group, Committee on Fiscal Affairs, Centre for Tax Policy and Administration, 2004) 15.

⁴ European Union, 'Compliance Risk Management Guide for Tax Administrations' (Directorate General Taxation and Customs Union, European Union Commission, 2010) 2.

⁵ OECD, 'Compliance Risk Management: Audit Case Selection Systems' (Information Note prepared by Forum on Tax Administration, Centre for Tax Policy and Administration, 2004) 7

⁶ OECD, *Audit Case Selection Systems*, (2004), 27.

⁷ Bonnie Lee, 'Why the IRS Picked You to Audit', *Fox Business* (online) March 22, 2012 <<http://www.foxbusiness.com/features/2012/03/22/why-irs-picked-to-audit.html>>.

legal jurisdiction to interfere in the internal distribution of work in tax administration. Although the division of functions in an organisation is important to prevent concentration of authority in the hands of a few, the nature and function of audit selection is such that both centre and field formations have to share information available at their levels and corroborate in making right selections. Case managers have local information about businesses and head office has data mining facility to generate case wise information from whole country. Nevertheless, the actual performance of an audit is recommended to be done by a separate team of administrators instead of the team which has selected the cases to prevent the misuse of authority.

This paper finds that the LHC has overlooked the latitude provided by the superior courts in tax matters as well as ignored the best international practices in this field. For example, in *M/S Ellahi Cotton Mills v Federation of Pakistan*, the Supreme Court of Pakistan allowed some taxpayers to be taxed under an entirely different tax regime (that is, the Presumptive Tax Regime). The LHC also appears to have also ignored the fact that most tax regimes must be discriminatory in order to secure some of their objectives, such as redistribution of income. Redistribution of income is possible mostly because of progressive taxation which is inherently discriminatory. The above mentioned latitude in tax matters is justified by superior courts on the basis that the public necessity is greater than the private. On the same footing, not giving freedom to tax administration at central office and case manager level to select taxpayers for audit may let some taxpayers get away with evading tax and that would appear even more discriminatory for the compliant taxpayers. This paper, therefore, concludes that a tax administration at both central and local level should be allowed to pick any taxpayer for audit even if that appears slightly discriminatory. Finally, this paper offers some suggestions to optimise selection of taxpayers for audit.

The paper is divided into five parts. Part 2 takes an overview of the audit process in the context of tax objectives and public expectation. Part 3 reviews process of selection for audit under the Self Assessment Scheme (SAS). This part also discusses the link between central and field offices for better quality of selection. Part 4 reviews the sections of old and new Pakistani income tax legislation pertaining to taxpayers' selection for audit. Later, this part offers a critical examination of the LHC decision in the context of relevant Articles of Constitution of Pakistan and judgments of the Apex Court. Part 5 presents recommendations to make the taxpayer selection more objective, transparent and fairer. Part 6 provides a conclusion.

2. TAX AUDIT: OBJECTIVES AND PUBLIC EXPECTATIONS

Historically, income tax was collected through the official assessment system whereby every taxpayer's returned version for each year had to be investigated through examination of their books of accounts. Later, high compliance and administrative costs in official assessments encouraged the government to introduce the SAS for collecting income tax. Under the SAS, every taxpayer was entrusted with the responsibility of assessing their income tax liability by complying with all the provisions of the Tax Code and declaring all activities generating income.⁸ The Tax Office mostly accepts these declarations after reviewing tax returns. However, some

⁸ Nobuaki Usui, *Penetration of the Self Assessment System for Income Tax Half-a-Century's Experience in Post War Japan* (2002) <<http://ideas.repec.org/p/idx/brikps/4599.html> accessed 4 November 2012>.

taxpayers are picked for audit of their tax affairs. Any mistakes by taxpayers under the SAS, whether deliberate or unintentional, when detected in the audit incur various levels of penalties⁹ that are aimed at discouraging non-compliance.

A tax audit is an investigation by tax authorities into the background of tax returns submitted by a taxpayer to ensure accurate filing of returns. The audit is an examination of a person's financial transactions of a person and includes assessment of both business and personal financial matters. An inquiry may be made into assets and expenditures of business and professional entrepreneurs. The extent of inquiry, however, depends on the facts of each case and may be limited to either merely a telephone call to the taxpayer or a more detailed investigation including visiting the taxpayer's premises.¹⁰

Generally the role of audit is to (1) detect individual cases of non-compliance; (2) promote voluntary compliance by increasing the probability of detection and penalties for non-compliant behaviour; (3) provide a good opportunity for tax administrations to educate taxpayers on their legal obligations or book-keeping requirements, thereby improving future compliance; and (4) gather information on the health of the tax system and the evasion techniques applied by taxpayers. More importantly, the audit must deliver in the SAS due to its punitive and enforcement role¹¹ so that a high probability of punishment to evaders is ensured. It is worth referring here to the goal of the Taxpayer Audit Program, as articulated by the Australian Tax Office (ATO) during the introduction of SAS in the Access and Equity Plan for 1991–92/1993–94:

To promote voluntary compliance through a balanced program which is seen by the community at large to be soundly based between taxpayer groups and which, within each group detects and brings to account those who do not pay their correct amount of tax.

The key message that will be sent to the target groups is that enforcement activity is undertaken as an incentive to voluntary compliance, not as a punitive measure. All complying taxpayers should rightfully expect that those who do not comply with their tax obligations do not benefit from that non-compliance.¹²

Right selection of taxpayers for audit in SAS is important for two main reasons. First, better the quality of the selection (right cases are picked up for audit), the higher the probability of detecting evading taxpayers.¹³ Studies show that higher the probability

⁹ Some countries (like Pakistan) do not use penalties for incorrect declarations in SAS returns (see *Income Tax Ordinance, 2001*, available at <<http://www.fbr.gov.pk>>).

¹⁰ Australian Tax Office, *Tax Audits—What are They?* (2012), <<http://www.ato.gov.au/individuals/content.aspx?doc=/content>, accessed 12 October 2012>.

¹¹ John Wickerson, *Managing the Risks to Revenue: A New Model for Evaluating Taxpayers Audit Programs* (PhD Thesis, University of Canberra, 1995) 355.

¹² *Ibid* 356.

¹³ Kent W Smith and Karyl A Kinsey, 'Understanding Taxpayer Behavior: A Conceptual Framework With Implications for Research', (1987) 21 *Law and Society Review* 4, 639–663. See also Silvia A Madeo, Albert Schepanski and Wilfred C Uecker, 'Modelling Judgments of Taxpayer Compliance' (1987) 62 *Accounting Review* 2, 323–342; Joel Slemrod, Marsha Blumenthal and Charles Christian, 'Taxpayer Response to an Increased Probability of Audit: Evidence From a Controlled Experiment in Minnesota' (2001) 79 *Journal of Public Economics* 3, 455–483.

is of being caught, the lesser are the tax evasive practices.¹⁴ Evading taxes is kind of gambling with the tax authorities. The risk or deterrence of being caught and losing money needs to be higher than the expected gain tax evasion. A study by the State Bank of Pakistan found that the lack of audits was responsible for poor tax collections in the years immediately after the introduction of the SAS in 2003. Further, negative growth of collections on demand occurred after 2003 when audits ceased.¹⁵

Correct selection of audit subjects also optimises resource allocation of the tax administration because every taxpayer indiscriminately cannot be subjected to audit due to resource constraints.¹⁶ Studies show that the greater the specificity in identifying the cases the lesser the number of selected cases.¹⁷

3. REVIEW OF PROCESS AND QUALITY OF SELECTION FOR AUDIT UNDER THE SAS

Although most tax regimes in developed economies have shifted to the SAS for reasons mentioned in Part 2, tax administrations have kept the statutory authority to audit any taxpayer either on the basis of objective criteria or even a hunch. Legislative framework in those countries allows tax administrations to scrutinise the tax affairs of any taxpayer. Thus, tax assessment ultimately remains a statutory prerogative of tax administrations, which perhaps explains why selection of cases for audit has not been challenged before the courts as unconstitutional or unlawful.

However, under the SAS, the process of improving the quality of taxpayer selection for audit has become the most important part of compliance management. The criteria used for selection is usually is not made public perhaps because divulging this information to taxpayers may help them strengthen tax evasion strategies.¹⁸ On the other hand, some tax administrations have recently made the criteria public (like Pakistan, which has revealed at least for 50 per cent of the relevant selection criteria) for the sake of transparency and to improve their tax risk management and thereby ensure voluntary compliance.¹⁹

The selection of cases for audit could be either random or on the basis of some criteria. Studies show that random selection of cases does not produce desired results²⁰ because they are not designed to target those with highest probability of non-compliance. Better quality of selection to ensure optimum compliance, therefore, is

¹⁴ Michael G Allingham and Agnar Sandmo, 'Income Tax Evasion: A Theoretical Analysis' (1972) 1 *Journal of Public Economics*, 323, 330.

¹⁵ State Bank of Pakistan, *Public Finance and Fiscal Policy, Annual Report 2006* <<http://www.sbp.org.pk/reports/annual/arf06/Chp-4.pdf>> 77.

¹⁶ Wickerson, above n 11, 353, 362; also see Margaret E Cotton, 'Selecting Cases for Audit — Getting It Right' (2007) *Asia Pacific Tax Bulletin*, 13.

¹⁷ Cotton, above n 16.

¹⁸ The Australian Tax Office (ATO) provided details on how it selects cases for audit first time in 2006 (see Michael Jenkins, 'Profit Shifting and ATO's Approach to Risk Profiling' (2007) *Asia Pacific Tax Bulletin*, 65; Office of Auditor General of Manitoba, Canada, 'Audit Findings and Recommendations' (2012), <<http://www.oag.mb.ca/reports/>> 304; also see PricewaterhouseCoopers, 'Korean National Tax Service Issues Guidelines for Selecting Candidates for Tax Audit' (2009) *Worldwide Tax Daily*, 188.

¹⁹ Jeyapalan Kasipillai, 'Malaysia-New Tax Audit Framework' (2009) 56 *Tax Notes International*, 2, 129; PwC, (2009), 188.

²⁰ See Wickerson, above n 11, 360.

generally based on risk management criteria of selection.²¹ The selection criteria could consist of quantitative and qualitative factors.²²

Based on quantitative and qualitative factors, there are three major pre-requisites for effective audit selection,²³ which are determined on the basis of the strike rate²⁴ (that is, proportion of audits and the increase in tax payable).²⁵ Firstly, pre- and post-audit information should be recorded in a well-developed ICT-based management system. Secondly, skilled audit selection teams need to be equipped with ICT, accounting and investigative instincts. Thirdly, the organisational commitment to an effective audit system is imperative. More simply, audit selection includes procedures and judgments to prioritise the work in order to make optimum use of the administrative resources.²⁶

Compliance cannot be ensured by a single action strategy²⁷ and thus the selection process in most developed jurisdictions consists of two levels. In the first level of strategic risk management, electronic data mining and statistical analysis techniques are used to identify the business sectors where there is likelihood of compliance risk.²⁸ This primarily involves a systematic filtering and prioritising exercise. This step of data mining requires well-developed ICT program as well as a reliable and authentic database, along with a team of highly skilled assessors to produce the desired results,²⁹ for example, Japan's national tax comprehensive management, Kohuzei Sougou Kanri, verifies, tabulates and processes data which is uploaded in the system.³⁰ Studies have noted that without support of ICT good case selection remains a difficult task.³¹ In the second level, the use of local knowledge by case officers is necessary, such as information that the car purchased in name of the wife is actually intended for a taxpayer.³²

In the Netherlands large business are selected for audit on an individual basis only.³³ Indeed, in most OECD countries, in terms of selection of large businesses for audit, the involvement of case managers is quite considerable.³⁴ Case reviews by auditors are considered the traditional method by which audit cases are selected, which was especially true during period when there was little or no ICT support available.³⁵ This perhaps explains why in developing countries selection by auditors is a common procedure.

²¹ OECD, 'Strengthening Tax Audit Capabilities: Auditor Workforce Management—Survey Findings and Observations' (Information Note prepared by Forum on Tax Administration, Centre for Tax Policy and Administration, 2006), 24.

²² Wickerson, above n 11, 357.

²³ OECD, above n 3, 5.

²⁴ Wickerson, above n 11, 358.

²⁵ OECD, above n 3, 9.

²⁶ Wickerson, above n 11, 353.

²⁷ OECD, above n 3, 6.

²⁸ Wickerson, above n 11, 354.

²⁹ OECD, above n 3, 10.

³⁰ Tapan K Sarker, 'Improving Tax Compliance in Developing Countries Via Self-Assessment Systems—What Could Bangladesh Learn From Japan' (2003) 9 *Asia Pacific Tax Bulletin*, 6, 173.

³¹ OECD, above n 3, 12.

³² OECD, above n 21, 16. See also, OECD, above n 3, 11.

³³ OECD, above n 21, 16.

³⁴ OECD, above n 21, 16–26.

³⁵ OECD, above n 3, 11.

More broadly, strategic risk management is done in the central offices of tax administration whereas the local selection process is carried out by the field formations. When the central and field offices operate in synchrony, synergy develops and the selection process produces better results. In practice, however, most selections are decentralised.³⁶ Some examples of developed tax jurisdictions follow so as to provide a better understanding of the role of central and field offices of tax administration in selection of cases.

In the US, the Internal Revenue Service (IRS) and Discriminate Function (DIF), which does macroeconomic statistical analysis, operate together to choose cases for audit.³⁷ The US uses highly specialised Centralized Examination Classification Systems (CECS) for macro level analysis.³⁸ Beyond that, the review of selection by states of Florida and Columbia show that personal observations are predominantly used for selection.³⁹

In Canada two tiers of tax administration are involved in the selection of cases. First the central office performs a statistical analysis and then the experienced auditors examine that data and, using local knowledge, select cases for audit.⁴⁰ Local knowledge plays a decisive role in audit selection.⁴¹ France and Japan also use collaboration between central and field offices for selection of cases.⁴² In contrast, the UK selection of cases for audit collectively or independently involves three tiers of tax administration.

New Zealand (NZ) has a Taxpayer Audit Selection System (TASS) whereby some cases are picked on the basis of selected queries. These cases are then exported to individual investigators to further scrutinise the returns. The investigators can also seek help from compliance risk officers (CROs) before making a final selection.⁴³ The individual auditors thus have the key role in selecting cases for audit.⁴⁴ A study based on a review of practices around the world conducted by Hasseldine shows that the NZ tax administration practice of audit selection is among the best in this regard.⁴⁵

Australia also has a variety of tax audits such as specific issue audits or reviews and comprehensive audits. The latter usually follow review audits and data matching based on the electronic system. They also rely on other factors such as errors in the taxpayer's returns, third party information or even suspicion of participation in a cash economy.⁴⁶ The ATO also announces the 'hit list' of areas which could be one reason

³⁶ Wickerson, above n 11, 354.

³⁷ OECD, above n 3, 15.

³⁸ OECD, above n 3, 20.

³⁹ Pappas Group, *What is Florida's Tax Audit Process?* <http://www.pappastax.com/article/business-facing-fdor-sales-tax-audit-will-want-read/>.

⁴⁰ OECD, above n 3, 24.

⁴¹ OECD, above n 3, 27.

⁴² OECD, above n 21, 17.

⁴³ New Zealand Inland Revenue Department, *Case Selection and the Conduct of Audits: Part 4, Performance of Taxpayer Audit* <<http://http://www.oag.govt.nz/2003/inland-revenue/part4.htm>>.

⁴⁴ New Zealand Inland Revenue Department, *What is an Audit?* <<http://www.oag.govt.nz/2003/inland-revenue/part4.htm>>.

⁴⁵ John Hasseldine, *Study Into Best Practices in Tax Administration* (Consultancy Report for National Audit Office, 2007).

⁴⁶ ATO, *How We Check Compliance* (2013) <<http://www.ato.gov.au/General/How-we-check-compliance/>>.

to pick the cases for audit in order to encourage taxpayers to fully comply with the tax code.⁴⁷ This procedure indicates that humans are actively involved in audit activities at the ATO.

Factors evident in the selection criteria of various countries demonstrates that quantitative (financial), qualitative (social and psychological) and other elements⁴⁸ collectively contribute to the selection criteria. Besides the objective indicators, factors used in the criteria also include items which are nothing but subjective judgments such as tips from other taxpayers or even hunches such as seeing something odd in a return.⁴⁹ There is certainly sufficient evidence on record that returns of corporations are often selected by humans instead of computers.⁵⁰

The above detailed review of selection of cases for audit by various tax administrations indicates that it is the tax administration which selects taxpayers for audit. Sometimes the central office selects on the basis of data mining; case managers act on the basis of subjective judgment; or both the central agency and case managers work in synergy. In most jurisdictions there is no fixed criteria provided by statute for the selection of taxpayers for audit which is followed by tax administrations. Indeed, criteria designed by tax administrations at different levels of hierarchy depend upon the latest facts and circumstances revealed by taxpayers. There is also no distinction provided in most tax jurisdictions between central and local offices in terms of their role in the selection of cases because they are part of the one and the same pillar of the state (executive) and that pillar is entrusted with the job of taxpayer selection to make the audit system effective.

The reason for not having fixed criteria is that there is a need for constant review and amendment of criteria. This flexibility enables tax administrations to adapt to the dynamic business world which often capitalise on the latest available tax avoidance and evasive opportunities. As mentioned above, the post-audit information is also very useful in the audit selection process because feedback from earlier audits help in updating selection criteria. This need for updates and amendments of the criteria after each audit exercise shows that they cannot be fixed. On the contrary, the criteria need to be constantly modified in an innovative way and therefore tax administrations should be given the liberty to adjust the criteria as and when required.

Overall the audit selection criteria are flexible in that quantitative and qualitative techniques by both computers and case managers respectively are used. The combination of statistical analysis by computers and intelligent judgment by humans is expected to synergise for good quality selection and to produce the desired results under the SAS.

⁴⁷ Mason Lloyd Accounting Firm (Australia) <<http://www.masonlloyd.com.au/blog?post=%2029>>

⁴⁸ Cotton, n 16, 12.

⁴⁹ AL Gutkin, *How Tax Returns Are Selected for Audit?*
<<https://totseans.com/totse/en/privacy/taxaudit.html>>.

⁵⁰ Ibid.

4. SELECTION PROCESS UNDER THE PAKISTANI TAX CODE

In order to understand the evolution of selection of taxpayer's audit, the legal framework under the repealed ordinance (*Income Tax Ordinance 1979*) and the new ordinance (*Income Tax Ordinance 2001*) is visited in the following sections.

4.1 Repealed ordinance

Under s 59 of the repealed ordinance,⁵¹ non-corporate taxpayers were provided with a self-assessment which was very liberal. The acknowledgment of filing of return was deemed as an assessment order. Only some cases were selected for audit by the central tax authority or its subordinate authorities by any method, which was prescribed by the central office. More simply, the method or scheme of selection was made part of the legal framework of the SAS. This shows that historically the selection, under the statute, was the domain of the central office with no or little role for the case managers.

4.2 New ordinance

The legal framework under the repealed ordinance regarding the selection of cases under SAS has been almost replicated in the new *Income Tax Ordinance 2001* except that now commissioners, who are case managers, can also select a case for audit.

There are two sections in the new Income Tax Ordinance which deal with taxpayer selection for audit. The first is s 177, which empowers the commissioner to call for taxpayer records after communicating the reasons for selection and then conduct the audit.

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:

⁵¹ **59. Self-assessment.**—(1) Where the return of total income for any income year furnished by the assessee [not being or a company engaged in the business of banking, leasing and modaraba,] under section 55 qualifies for acceptance in accordance with the provisions of a scheme of self assessment made by the Central Board of Revenue for that year or under any instructions or orders issued there under, the [Deputy Commissioner] shall assess, by an order in writing, the total income of the assessee on the basis of such return and determine the tax payable on the basis of such assessment.

[*Explanation.*—For the removal of doubt it is hereby declared that a return of total income furnished under section 55 does not include a return of total income furnished under section 57.]

(1A) Notwithstanding anything contained in sub-section (1), the Central Board of Revenue or any authority subordinate to it, if so authorized by the Central Board of Revenue in this behalf, may, in accordance with a scheme referred to in sub-section (1), select out of returns referred to in that sub-section any cases or classes of cases or persons or classes of persons, howsoever determined, for assessment under section 62, and the [Deputy Commissioner] shall proceed to make the assessment under that section or, if the circumstances so warrant, under section 63, accordingly.

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.

(3)⁵²

(4)⁵³

(5)⁵⁴

(6) After completion of the audit, the Commissioner may, if considered necessary, after obtaining taxpayer's explanation on all the issues raised in the audit, amend the assessment under sub-section (1) or sub-section (4) of section 122, as the case may be.

(7) The fact that a person has been audited in a year shall not preclude the person from being audited again in the next and following years where there are reasonable grounds for such audits ...

(8) The [Board] 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*

⁵² Subsection (3) omitted by the *Finance Act 2010*. The omitted subsection (3) read as follows: '(3) The Board shall keep the criteria confidential'.

⁵³ Subsection (4) omitted by the *Finance Act 2010*. The omitted subsection (4) read as follows:

(4) In addition to the selection referred to in sub-section (2), the Commissioner may also select a person or classes of persons for an audit of the person's income tax affairs having regard to —

- (a) the person's history of compliance or non-compliance with this Ordinance;
- (b) the amount of tax payable by the person;
- (c) the class of business conducted by the person; and
- (d) any other matter which in the opinion of Commissioner is material for determination of correct income.

⁵⁴ Subsection (5) omitted by the *Finance Act 2010*. The omitted subsection (5) read as follows:

(5) After selection of a person or classes of persons for audit under sub-section (2) or (4), the Commissioner shall conduct an audit of the income tax affairs (including examination of accounts and records, enquiry into expenditure, assets and liabilities) of such person or classes of persons.

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.

The second is s 214(c), which empowers the central office (FBR) to select cases for audit through either random or parametric method. However, the procedure for conducting audit shall be the same as provided in s 177.

214C. Selection for audit by the Board.

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

(2) Audit of Income Tax affairs of persons selected under sub-section (1) shall be conducted as per procedure given in section 177 and all the provisions of the Ordinance, except the first proviso to sub-section (1) of section 177, shall apply accordingly.

(3) For the removal of doubt it is hereby declared that Board shall be deemed always to have had the power to select any persons or classes of persons for audit of Income Tax affairs.

A review of the current legal framework shows that central selection has to be parametric, which means it should be based on reasons. On the other hand, despite the fact that the statute has given some authority to case managers to pick cases for audit, they have yet to disclose the reasons as to why an individual taxpayer has been picked. In contrast to the practice in other countries as discussed in Part 3, case managers in Pakistan cannot act on the basis of mere belief or 'hunch'. Rather, they have to disclose the specific reasons to the taxpayer. In other countries, the method is disclosed and communicated for the sake of transparency and not as a statutory

requirement. This indicates that the authority of selection for audit is comparatively constrained in Pakistan as both central office and case managers have to officially disclose any reasons.

Further, the reasons, which are required to be communicated to taxpayers on their selection, are mostly open to challenge before the courts in terms of whether they are sufficient and reasonable. This statutory requirement in Pakistan has made the criteria for selection relatively inflexible. Hence, tax administration in Pakistan has limited discretion when compared to other countries.

A review of the old and new legal framework therefore shows that there is a tendency in Pakistan to maintain the function of selecting taxpayers for audit with the central office and that case managers are not called to collaborate on the selection. Since case managers historically have on many occasions offered useful insights in terms of individual cases they perhaps should have more say in the selection process. Furthermore, there is no rationality in statutorily splitting the tax administration into two tiers, that is, central office and case managers, because they are actually both part of the same organisation with frequent exchange of officers. Although splitting the tax function may be essential for the prevention of concentration of authority and its misuse, it is not advisable to split the function of selection for audit. By its nature, this process requires close collaboration and sharing of information between centre and field formations to make the right selections. Nevertheless, the audit performance function should be separated from audit selection to prevent concentration of authority.

In a developing country like Pakistan, where making the right selection is already a hard task due to less developed tax administration and a large cash economy, the less discretionary and inflexible selection procedure under the existing legal framework has resulted in protracted litigation and an ineffective audit system. Despite a decade-long and very expensive tax reform process under the auspices of the World Bank, whereby the SAS was introduced, Pakistan still has not been successful in developing an undisputed and effective system for taxpayer selection and audit.

4.3 Does selecting a taxpayer for audit violate civil rights?

Adding to the weakness in the Pakistani legal framework discussed above, the LHC has recently held that the selection by commissioners under s 177 is discriminatory and violates the civil rights of a citizen, which are enshrined under the Constitution of Pakistan.⁵⁵ The court concluded that s 177 is ultra vires and illegal. Furthermore, the LHC offered this verdict under Article 199 of the Constitution of Pakistan which gives High Courts of states/provinces an original jurisdiction to issue an order of mandamus in matters where adequate remedy under the law is not provided.⁵⁶ Consequently, the selection process in Pakistan reverted to the position that prevailed under the repealed ordinance where only the central office under its SAS could select the cases. Whether or not the LHC has examined all the legal and conceptual facets of the subject and considered internationally accepted best practices in this regard before reaching its conclusion is discussed below.

⁵⁵ *M/S Chenone Stores Ltd v Federation and Others in Constitutional Petition No. 393 of 2012 reported as 2012 TAX 109 and 2012 PTD 1815*.

⁵⁶ Article 199, Constitution of Republic of Pakistan <<https://pakistanconstitutionlaw.com/article-199-jurisdiction-of-high-court/>>. Similar jurisdiction also rests with superior courts in other jurisdictions. For example, in Australia s 39B of *Judiciary Act 1903* (Cth) grants the Federal Court of Australia with jurisdiction to order mandamus <http://www.austlii.edu.au/au/legis/cth/consol_act/ja1903112/s39b.html>.

4.3.1 Selection for audit and scope of Article 10A

In *M/S Chenone Stores Ltd*⁵⁷, the LHC held that s 177, which empowers the commissioner to select a taxpayer for audit, violates Articles 10A, 18, 23 and 25. The decision basically raises three questions. First, is s 177 really discriminatory? Second, can a tax statute contain provisions which are discriminatory? Third, can ss 177 and 214(c) be aligned with internationally adapted best practices regarding selection criteria for taxpayer audit? These questions are discussed further below.

The LHC held that a provision of law, which is ex-facie discriminatory, also violates the right to due process (this also covers the right to a fair trial and is enshrined in Article 10A),⁵⁸ because the fundamental rights in the constitution exist in a symbiotic relationship. Therefore violation of one right can cause prejudice to other related rights. The relevant part of the decision is reproduced below.

These skeletal provisions lack check on the exercise of power by the commissioner, who is therefore free to pick and choose any person or taxpayer for audit. The requirement of giving reasons in the first proviso to section 177 (1) does not remedy the inherent flaw. In fact giving reasons reaffirms the targeted approach of the tax regulator. ... Legislative policy of the Ordinance cannot equip the commissioner with naked power to pick and choose according to his whims and wishes. Even though the Commissioner may be the best person in the system to identify a tax default, he cannot enjoy unguided discretion but only exercise discretion which is under a legislative guideline showing structured, uniform and transparent exercise of discretion. Hence these provisions as they stand are ex-facie discriminatory and give an un-checked license to the Commissioner. Any provision of the law that is ex-facie discriminatory also offends the right to 'due process' under Article 10A. Fundamental rights in our constitution have a symbiotic relationship. They are interrelated and mutually support each other. A provision of law that is ex-facie discriminatory and is also being applied discriminatorily cannot pass the text of the due process under Article 10A of the Constitution. Similarly, any such illegal and unconstitutional invasiveness to call for the record for verification is extra burden on the taxpayer and unduly interferes with his business offending Articles 18 and 23 of the Constitution. Hence section 177(1) and its first proviso offend Article 10A, 18, 23 and 25 of the Constitution.⁵⁹

A critical perusal of the court's findings leads to the following conclusions. First, the probing of any taxpayer on the part of the tax agency, in order to ensure that no violation of tax law is committed, in itself may not violate any civil rights in general and the right to a fair trial in particular. More simply, a civil right of equal protection does not make any person immune from a reasonable probe for the purpose of enforcement of a law. For the same reason, the Bill of Taxpayer Rights passed by the US congress does not provide a taxpayer with any right to challenge selection for audit,

⁵⁷ *M/S Chenone Stores Ltd*, above n 55.

⁵⁸ s 10A. [Right to fair trial: For the determination of his civil rights and obligations or in any criminal charge against him a person shall be entitled to a fair trial and due process.].

⁵⁹ *M/S Chenone Stores Ltd*, above n 55 at 30 [32].

which is the prerogative of the IRS.⁶⁰ Similarly, the legal frameworks of the sample countries discussed above also demonstrated that selecting cases is a statutory function of tax agencies across the world. Nevertheless, under certain tax regimes it is a taxpayer's right to know that why they have been selected and the tax agency has to provide the reasons.⁶¹ However, those reasons are not open to challenge in court. Thus, the LHC can be seen to have acted against this basic understanding of the process for case selection. More importantly, it is also widely acknowledged that legislation needs to provide the administration with wide powers for information gathering which is essentially related to the performance of the administration's functions under the law. An audit is a process of verification by obtaining relevant information which cannot be denied to a tax agency.

Second, s 177 does not violate the 'substantive due process' enshrined in Article 10A because the returns filed under the ordinance are deemed as assessed under s 120(1) and statutorily these returns are liable to a possible audit under s 120(1A). All citizens of Pakistan have been given identical treatment under the law. It is incorrect to assume that 'substantive due process' is violated merely because specific criteria for selection by the commissioner have been omitted from s 177. In this regard, the LHC's following remarks also require comment.

It is for the reason that, in the past, section 177 specifically provided a guideline and a criteria for the Commissioner to observe before selecting a person for audit. The under mentioned criteria re-examined on the statute till 27-10-2009:

- (a) The person's history of compliance or non-compliance with this ordinance;
- (b) The amount of tax payable by the person;
- (c) The class of business conducted by the person; and
- (d) Any other matter which is in the opinion of the Commissioner is material for determination of correct income.

Subsection (d) above meant that the Commissioner could add to the list of existing criteria for carrying out selection of the taxpayer for audit.⁶²

The court held that 'the provisions are noticeably silent regarding parameters, guidelines or criteria which can form the basis for triggering the said provisions into the motion'.⁶³

The court's remark that legislative guidelines, like the one present in the form of four criteria in s 177 until October 2009, are mandatory for the completion of the due process is also defective. Providing taxpayers with specific statutory reasons is not compulsory under the best practices for selection in most developed jurisdictions. As stated in Part 2, the dynamic nature of business and changing taxpayer compliance

⁶⁰ See Marvin E Owen, *IRS Audit and Your Bill of Rights* (10 December 2012) <<http://www.meocpa.com/irsaudit.html>>.

⁶¹ See IRS, *Part-4 Examining Process, Internal Revenue Manual* <http://www.irs.gov/irm/part4/irm_04-001-003.html#d0e135>.

⁶² *M/S Chenone Stores Ltd*, above n 55 at [Para 27 on Page 25].

⁶³ *M/S Chenone Stores Ltd*, above n 55 at Para 29 at Page 26.

behaviours demand that criteria for selection should be flexible rather than fixed criteria in the statute. The LHC therefore needs to provide stronger reasoning in order to challenge the mechanism of selection in developed tax jurisdictions.

Consistent with Part 4.2, even without the four criteria, commissioners are required to give reasons, thus the court's insistence on statutory criteria is not logical. Interestingly, s 214(c) also does not contain any specific statutory criteria for selection but that section has not been pronounced unconstitutional by the court, which reflects contradiction within court's own judgment. Put more broadly, the audit selection under s 177 neither causes any unreasonable probes, searches or seizures nor does it cause double jeopardy. Hence it should be seen strictly in terms of 'procedural due process'.⁶⁴ Moreover, in tax matters courts have previously allowed searches for the fair enforcement of tax laws. For example, in respect of sales tax the courts have justified searches of taxpayers without a warrant if the circumstances so demand.⁶⁵

Lastly, the above finding of LHC is inconsistent with the very spirit of taxation which suggests redistribution of income from rich to poor through inequitable and relatively large tax burden on rich as compared to poor sections of population. For example, progressive taxation and varying tax rate regimes for different classes of income are discriminatory but have been held as constitutional by the courts. Even presumptive tax regimes are justified for persons who otherwise escape taxation due to their activities in informal sectors.

4.3.2 Analysis of scope of Articles 18 and 23 and the selection for tax audit

The LHC held that because audit selection, being discriminatory, causes unconstitutional invasiveness which consequently interferes with the taxpayer's business, it therefore violates Articles 18⁶⁶ and 23.⁶⁷ As a result, the taxpayer cannot carry on their business. The relevant part of the court's decision is reproduced below.

A provision of law that is ex-facie discriminatory and is also being applied discriminatorily cannot pass the text of the due process under Article 10A of the Constitution. Similarly, any such illegal and unconstitutional invasiveness to call for the record for verification is extra burden on the taxpayer and unduly interferes with his business offending Articles 18 and 23 of the Constitution.⁶⁸

⁶⁴ The Free Dictionary <<http://legal-dictionary.thefreedictionary.com/Due+Process+of+Law>>.

⁶⁵ *Messrs Food Consults (Pvt.) Ltd. Lahore and another v Collector Excise and Sales Tax Lahore and two others* (2004 PTD 1731).

⁶⁶ **18. Freedom of trade, business or profession:** Subject to such qualifications, if any, as may be prescribed by law, every citizen shall have the right to enter upon any lawful profession or occupation, and to conduct any lawful trade or business:

Provided that nothing in this Article shall prevent:—

(a) the regulation of any trade or profession by a licensing system; or
 (b) the regulation of trade, commerce or industry in the interest of free competition therein; or
 (c) the carrying on, by the Federal Government or a Provincial Government, or by a corporation controlled by any such Government, of any trade, business, industry or service, to the exclusion, complete or partial, of other persons.

⁶⁷ **23. Provision as to property:** Every citizen shall have the right to acquire, hold and dispose of property in any part of Pakistan, subject to the Constitution and any reasonable restrictions imposed by law in the public interest.

⁶⁸ *M/S Chenone Stores Ltd*, above n 55 at [Para 32 on Page 30].

The court, however, has failed to explain how a civil or a criminal audit started with valid reasons by a statutory agency could cause interference in a business and how a legal inquiry could obstruct a taxpayer carrying on their lawful business or profession. In this case the taxpayer will have been provided with all their rights during the audit process and no prejudice may be caused to them before or even after the conclusion of the audit. The taxpayer also has the right to appeal against the outcome of the audit before various appellate authorities from the Commissioner (Appeals) to the Supreme Court. Further, the court has also failed to appreciate that the SAS puts less of a burden on taxpayers as compared to official assessments which envisage investigating every taxpayer. A tax regime containing the SAS with a few taxpayers selected for audit every year is much less cumbersome than the regime which envisages official assessment of every case every year.

In addition, the LHC's judgment has two conceptual faults. First, even when a provision of law causes interference with taxpayers' businesses the courts have traditionally allowed it for the welfare of the public. This is on the basis of the famous maxim, *Salus populi est suprema lex* ('the welfare of the people is the paramount law') and *Necessitas publica major est quam private* ('public necessity is greater than private'). In Pakistan, which has a less resourceful tax administration and a poor tax to GDP ratio (that is, less than 10 per cent), the selection of cases, like other investigations under other laws by other agencies, could not be wholly carried out on the basis of rigid statutory criteria. Therefore, as other government agencies operate with the flexible tools, the FBR should also not be stopped from selecting cases for audit because this may result in a loss of public revenue.⁶⁹ This is particularly significant when we consider that the method of selection adapted by the FBR is much less invasive than the practice followed by more developed tax jurisdictions.

Second, under this very principle of public benefit, courts have previously determined that presumptive income taxation (PIT) is lawful when there is a large informal economy and massive tax evasion.⁷⁰ This is despite the fact that PIT treats all persons equally and even charges tax against persons with no income or those who have made a loss. The courts also have held that the power to search without a warrant is lawful under s 40 of the *Sales Tax Act 1990* when carried out with a statement of the grounds of belief by the officer.⁷¹ As stated in Part 3, in the German Tax Code, the basis of assessment of various incomes is set out differently which shows that jurisprudence and best practice on selection of cases gives leverage to taxation and allows it to not observe absolute uniformity.

4.3.3 Analysis of scope of Article 25 and the selection for tax audit

Regarding Article 25 (Equality of citizens), the LHC has held that audit selection by the Commissioner IR under s 177 is discriminatory, as no due process is provided in the law. Thus it violates Article 25 which guarantees equal protection of law for all citizens.⁷²

⁶⁹ *Ch. Muhammad Ishaq Advocate v Cantonment Executive Officer, Chunian, District Kasur* (PLD 2009 Lah. 240).

⁷⁰ *Ellahi Cotton Mills v Federation of Pakistan* (PLD 1997 SC 582).

⁷¹ *Messrs Food Consults (Pvt.) Ltd.*, above n 65.

⁷² **25. Equality of citizens:** (1) All citizens are equal before law and are entitled to equal protection of law.

(2) There shall be no discrimination on the basis of sex.

In its pronouncement the court also failed to take into account two important aspects. First, the Supreme Court of Pakistan has already stated that elements of discrimination in a fiscal statute cannot be pleaded nor can such a statute be struck down on the basis of Article 25 of the Constitution. As a result, there are many examples where various incomes, persons and industrial sectors are taxed differently. For example, income from manufacturing is subject to tax in Pakistan while agricultural income is not. For effective taxation superior courts in India have allowed varying tax regimes for different classes of persons based on reasonable and rational differentiation.⁷³ The Supreme Court also mentioned that progressive taxation taxes citizens differently at varying levels of income for the sake of public welfare and to remove economic disparity.⁷⁴ Thus we can see that the equality of all citizens under Article 25 is violated when citizens are taxed in such a way as to achieve economic equality.

More specifically, in *Anoud Power Generation Ltd v Federation of Pakistan*, the Supreme Court held that different laws can be promulgated to deal with various types of persons albeit subject to a reasonable classification.⁷⁵ In *NWFP Public Service Commission v Muhammad Arif*, the Supreme Court opined that it is also not for courts to demand from the legislature scientific accuracy in the classification adopted. If the classification is relevant to the object of the Act, it must be upheld unless the relevancy is deemed too remote or fanciful. A classification that proceeds on irrelevant considerations, such as differences in race, colour or religion will certainly be rejected by the courts (although no such thing has been pointed out by petitioners in the audit selection process).⁷⁶ More broadly, in *Mir Hashmat v Birendra Kumar Ghosh and Others*, Dacca High Court decided that any reasonable classification, which is not violative of the doctrine of equality, cannot be questioned.⁷⁷

Similarly, in *IA Sherwani v Government of Pakistan* the Supreme Court held that the Constitution itself contemplates passing of different laws for different provinces by their respective legislatures. The doctrine of reasonable classification is founded on the assumption that the state has to perform many activities and deal with a vast number of issues and problems. Therefore it should have the power to make a reasonable classification of persons and things to which different treatment may be accorded. Provided there is a legitimate basis for such difference the state can make laws to attain special objects and administrative authorities may make classifications in pursuance of such laws.⁷⁸

The Indian Supreme Court in *Indian Bombay v Bhanji Munji and Others* held that 'a law applying to one person or one class of persons is constitutional if there is sufficient basis or reason for it'.⁷⁹ The court, in the case of *DS Nakara v Union of India*, further held that:

The fundamental principle is that Article 14 forbids class legislation but permits reasonable classification for the purpose of legislation which

(3) Nothing in this Article shall prevent the State from making any special provision for the protection of women and children.

⁷³ *Kunnathat Thathunni Moopil Nair etc v State of Kerala and another* (AIR 1961 SC 552; 3 SCR 67).

⁷⁴ *Ibid*, at page 96.

⁷⁵ *Anoud Power Generation Ltd v Federation of Pakistan* (PLD 2001 SC 340).

⁷⁶ *Mir Hasmat Ali v Birendra Kumar Ghosh and others* (PLD 1965 Dacca 88).

⁷⁷ See *NWFP Public Service Commission v Muhammad Arif* (2011 SCMR 848).

⁷⁸ *IA Sherwani v Government of Pakistan* (1991 SCMR 104).

⁷⁹ *State of Bombay v Bhanji Munji And Anr* (AIR 1951 SC 41).

classification must satisfy the twin tests of being founded on an intelligible differentia which distinguishes persons or things that are grouped together from those that are left out of the group and that differentia must have a rational nexus to the object sought to be achieved by a statute in question.⁸⁰

While such distinctions may create some martyrs they necessarily have to be accepted for the general welfare of the public.⁸¹

Second, the selection for audit does not cause adverse distinction in terms of a benefit for a group or an individual. Selection or no selection means nothing in monetary terms unless some discrepancy is found in the tax return as a result of the audit. As stated in Part 3, there are no fixed criteria for tax agencies in terms of choosing any case for civil audit or even for investigative audit and nowhere in the developed world is selection for audit considered a violation of civil rights. Even if selection causes apprehension, this should not deprive a tax agency of the role of 'watch dog', ensuring that everyone complies with the SAS which has been introduced in the spirit of reducing compliance costs in official assessments.

Taking away from case managers this selection right would more likely result in non-compliance which ultimately leads to greater inequity. As stated in Part 1, inequity caused by lack of tax enforcement enhances feelings of discrimination among compliant taxpayers. Therefore, consistent with Part 1, it is suggested that in Pakistan taxpayer selection for audit should be carried out through the combined role of central and field officers. Commissioners should utilise the data prepared by FBR along with their local knowledge of individual taxpayers in order to pick the right taxpayers for audit.

However, in order to inculcate transparency it is advisable that 'self-selection' be avoided. Instead, this task may be assigned to Risk Intelligence and Analysis Teams working independently from teams performing audits. Separation of functions between various wings of government agencies improves internal controls and dilutes absolute authority to prevent misuse.⁸²

5. RECOMMENDATIONS

This review of international best practices for taxpayers' selection for audit and critical analysis of the issue of civil rights in the context of taxpayers' selection indicates that absolute uniformity or equality is not recommended for better selection of taxpayers for audit. More simply, the tax administration should not be provided with inflexible criteria in terms of picking cases for audit. Instead, the administration should be given the liberty to pick any taxpayer who is considered to have a high probability of being involved in tax evasion.

In order to ensure that the tax administration does not act arbitrarily or a case manager with too much authority is not biased against any individual taxpayer, the function of selection and carrying out of the audit should be allocated to two separate teams or divisions within the administration. Collaboration between central office and field

⁸⁰ *DS Nakara v Union of India* (AIR 1983 SC 130).

⁸¹ *Sonia Bhatia v State of UP* (1981) 3 SCR 239, 258; AIR 1981 SC 1274, 1284.

⁸² Nick Szabo, *Patterns of Integrity—Separation of Duties* referred by Nick Kochan and Robin Goodyear, "Corruption: The New Corporate Challenge" (2011) Palgrave McMillan p-164

formation for selection is essential due to the nature of this function which involves the use of taxpayer specific information at both levels. In addition, the processes of selection of cases and performance of audit should be totally transparent in order to develop trust between taxpayers and the tax administration. Further, for any tax administration to operate efficiently and honestly some prerequisites such as sufficient skills, high remuneration, appropriate performance evaluation mechanisms and suitable internal controls are mandatory in general and necessary for the success of SAS in particular.

In terms of making the criteria for taxpayer selection flexible in Pakistan, it is suggested that ss 177 and 214(c) should be accordingly amended. The criteria for selection should not be provided in law and the function of designing criteria should be delegated to the tax administration so that it can be resilient and able to be adjusted each year in accordance with the facts of that year. As noted above and seen in the good practices of developed countries, better selection relies on collaboration between the central office and field formation. Such collaboration ensures the optimum use of centrally prepared data analysis reports with local information.

Moreover, following the well-known anecdote that 'one size does not fit all' it is recommended that selection from all categories of taxpayers cannot be carried out using identical criteria. This is because the relevant information for each category is different as are the different tools used in evading taxes. Well-developed ICT systems for obtaining, sorting and manipulating third party information and sector specific criteria are essential.

Finally, the quality of selection and results of any audit should be watched through well-defined benchmarks for the purpose of efficiency and control.

6. CONCLUSION

Under the SAS, the correct selection of cases for audit is an important part of designing tax compliance strategy. Correct selections help catch tax evaders thereby generating the perception that the tax system is fair and no one escapes taxation, which is most satisfying for compliant taxpayers.

Tax administrations have usually been given the liberty via statute to pick any case for audit, mostly due to the demands of the ever changing world of business. New ways of evading taxes need to be tackled with innovative means of detection. Best practice selection is partly based on the objective criteria arising from data analysis by the central office and also on the subjective judgment of case officers. A review of legal frameworks in Canada, Germany, Singapore, New Zealand, Australia and India reveals that liberty is given to tax administrations in those countries in terms of selection of cases for audit. Although the constitutions of those jurisdictions, like that of Pakistan, protect the fundamental right of equality of citizens, the courts have not pronounced such freedom of selection as discriminatory.

Although tax administrations have been improving their systems of selection for audit, allegations of discriminatory treatment do arise. For example, the LHC in Pakistan has held that a taxpayer's selection for audit by a case officer without fixed statutory criteria is discriminatory and violates the right of equality of all citizens enshrined in the Constitution. With this statement LHC has ignited a crucial debate about whether

tax statute, which empowers the agency to pick any case for audit on the basis of subjective criteria, violates the right of equality and consequently is ultra vires to the Constitution. Despite the fact that the Pakistani Tax Code also empowers both case managers and central office to select any taxpayer, the LHC has held that the power to select on the basis of risk parameters and without fixed statutory criteria violates the right of equality of citizens. The LHC has therefore noted that an objective and fixed criteria must be statutorily designed, otherwise the selection is unconstitutional.

A critical analysis of the LHC decision finds that the court, while suggesting fixed criteria for case managers, has erred in treating case managers and the central office as distinct administrative entities rather than just two parts of the FBR that is the sole federal tax administrator. The case managers report to the head office and are under control of head office. Therefore, this distinction between case managers and head office is poor. Although a division of functions within an organisation is essential for prevention of concentration of authority, the nature and function of selection for audit is such that central and field formations need to corroborate and share information available at their level in order to make right selections. The case managers have local information about businesses and head office has data mining facility to produce information of each business on overall country basis. Nevertheless, carrying out an audit should be assigned to a different team from that which is engaged in the selection so as to curb the misuse of authority.

The LHC, besides ignoring the best international practices, also has completely overlooked the latitude provided in tax matters by superior courts of various jurisdictions. It appears to have disregarded that discrimination in tax matters is allowed by superior courts for a variety of reasons, such as for the sake of securing the objective of redistribution of income through progressive taxation. Several tax regimes understand that a progressive tax rate means treating individuals under different economic circumstances differently in order to achieve redistribution of income. Different tax regimes for different sections of persons are held to be lawful in order to ensure effective taxation across the board and to see that no one escapes taxation, which would create a perception that the tax system is unfair. Such classifications are justified by both legislatures and superior courts on the basis of the principle that the public necessity is greater than the private.

Similarly, not giving the administration liberal power to select taxpayers for audit may enable some taxpayers to get away with evading payment. Treating equals un-equally is in fact more discriminatory. A tax administration should be allowed to pick any taxpayer for audit in terms of overall public benefit even if that appears discriminatory on the surface. This paper also recommends areas for improvement in quality of taxpayer selection for audit.