

Government of Pakistan
Revenue Division
Federal Board of Revenue
(Legal Wing)

C.No.3(08)SS(A&A)/2023/

Islamabad, the 28th March, 2025

All Chief Commissioners-IR
LTOs/CTOs/MTO/RTOs

SUBJECT: MANDATORY COMPLIANCE WITH STATUTORY AUDIT PROCEDURES UNDER SECTION 177 OF THE INCOME TAX ORDINANCE, 2001 – INSTRUCTIONS & ADVISORY

The Honorable Appellate Tribunal Inland Revenue in its recent judgment in the case of Mr. CM Rafi, Maj. General (Rtd) Vs. DCIR AEOI Zone, Islamabad (Authored by Malik Muhammad Akram, JM) has dilated upon the procedure for conducting audit u/s 177 and subsequent steps for framing legally sound assessment orders. A brief summary of structured approach that has been formally sanctioned by the Tribunal are as under:

1. Legal Imperatives for Audit Proceedings under Section 177 of the Income Tax Ordinance, 2001

A. Audit Report is Mandatory:

An audit report under Section 177(6) must be issued after completing the audit, detailing observations, findings, and proposed adjustments.

Non-compliance (e.g., omission of a formal audit report) renders the assessment void ab-initio (refer to 2018 PTD 1444 and 2022 125 TAX 354).

B. Confrontation of Findings:

Taxpayers must be given a clear opportunity to respond to all audit observations in writing before finalizing the report. Specific discrepancies (e.g., unexplained credits, unreported income) must be quantified and legally substantiated in the report.

2. Procedural Steps for Conducting Audits

Field formations must adhere to the following sequence:

A. Initiation of Audit

Issue an intimation letter under Section 177(1) specifying:

- i. Reason for selection (random/parametric).
- ii Tax year under audit.
- iii Documents/records required (books of accounts, bank statements, etc.).

B. Examination & Audit Report

- i. Document all proceedings on the order sheet (quasi-judicial requirement under Section 224).
- ii. Issue a formal audit report under Section 177(6) containing:
- iii. Executive summary of findings.
- iv. Legal basis for each discrepancy (e.g., Section 111(1)(b) for unexplained assets).
- v. Quantified adjustments with calculations (e.g., sectoral benchmarks for income estimation).

C. Taxpayer's Right to Explain

Allow the taxpayer to:

- i. File revised returns under Section 114(6A) (with reduced penalties if compliance is timely).
- ii. Submit rebuttal evidence before issuance of the show-cause notice under Section 122(9).

D. Best Judgment Assessment (If Records Not Provided)

- i. If the taxpayer fails to furnish records, proceed under Section 177(10) read with Section 121 (best judgment assessment).
- ii. Do not continue audit proceedings without records—switch to Section 121 immediately.

3. Critical Deficiencies to Avoid

The ATIR highlighted the following common lapses leading to judicial annulment:

- i. Audit reports Findings must be specific, legally grounded, and backed by evidence.
- ii. Any new discrepancy (e.g., unreported foreign income) must be separately confronted via a supplementary notice (CIR vs. RYK Mills, 2023 SCMR 1856).
- iii. Maintain a detailed order sheet for every interaction with the taxpayer.

4. Directives for Compliance

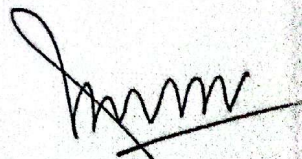
- i. Training: Commissioners must conduct workshops on the proper drafting of audit reports and confrontation procedures.
- ii. Review Mechanism: Chief Commissioners shall randomly audit 10% of closed audits to ensure procedural compliance.
- iii. Accountability Non-compliance will attract disciplinary action under the FBR's performance rules.

5. Conclusion

Strict adherence to the above instructions is imperative to uphold the integrity of assessments and minimize litigation. The ATIR's order underscores that procedural lapses invalidate assessments, regardless of substantive merits.

Immediate action is expected to disseminate these instructions to all assessing officers under your jurisdiction.

Encl: Copy of ATIR Order Dated 16.01.2025


(Mir Badshah Khan Wazir)
Member-IR (Legal)