

# Tax Review/Taxation

## Daily Alert Services

Huzaima & Ikram

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Kind regards

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## Who pays taxes anyway

by  
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Democracy is a form of government in which all eligible citizens participate equally - either directly or through elected representatives - in the proposal, development and creation of laws. It encompasses social, economic and cultural conditions that enable the free and equal practice of political self-determination.- Wikipedia.

From the above definition, it is logical to construe that in a democracy if everyone participates equally in the proposal, development and creation of laws, the majority - the middle to lower masses - will be better off. Since the proletariat, the 99%, immeasurably outnumbers the bourgeois, the 1%, taxation laws, under a democracy, must therefore ensure that the rich pay exceedingly more taxes. Hence, income inequalities can therefore not exist, let alone flourish, in a democracy. If that is not happening, then either there is no democracy, or more significantly, democracies' very premise is faulty.

The news originating out of the world's oldest democracy, irrespective of the efficacy of the claim, is however, not very encouraging. The popular view there is that the rich are getting richer and the poor are getting poorer. How can that be? Don't the poor vote for their representatives who then aggressively protect the former's interest ensuring that the rich pay more taxes to subsidise the poor? Admittedly, the voting poor can have made a mistake in choosing their representatives once or twice, but how can they make blunders for decades?

**SOMETHING IS NOT RIGHT IN UTOPIA!** On the premise that the headlines from the west are tampered with by the sensationalising media, the analysis is diverted towards the domestic situation. After all, by now the nation has enjoyed democratic rule for six successive years, which is sufficient time for the elected representatives of the poor masses to have tilted the balance in the latter's favour.

All of the data used for the below analysis has been downloaded from FBR's (Federal Board of Revenue) website and diligently chewed over. Nonetheless, there is always a possibility of inadvertent errors which may be condoned since the objective is to broadly confirm the hypothesis as opposed to an unvarnished truth. One more thing, FBR has not gotten around to posting the annual details of tax collected for 2012-13, accordingly the references for 2013 is for the nine-month period ended July, 2012 to March, 2013.

At the outset the breaking news is that out of the Rs 1.352 trillion collected till March 2013, withholding income tax (WHT), sales tax, Federal Excise Duty (FED) and custom duty collection amount to Rs

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\* The writer is a chartered accountant based in Islamabad.

1.147 trillion, almost 85%. The argument that WHT a direct tax is proved to be fallacious by the fact that only Rs 38 billion relates to withholding on dividend and interest on bank deposits and Rs 16 billion only relates to exports; WHT on imports and contracts is, under all likelihood, added to the consumer price. By the way, WHT on electricity bills and telecommunication totalled Rs 29 billion which means that even in the absence of taxable income consumers of these utilities paid income tax. In theory these are refundable, but when has the tax collector ever been happy about dishing out money.

Accordingly, in 2013, almost 81% of the tax collected was regressive, meaning that low-income persons paid most of it. The comparable percentage for 2008 is 79%. The poor are hence 2% worse off after 5 years. Curiously, income tax collection on demand, net off refunds, up-till March 2013, is Rs 7 billion only. Tax collection on demand refers to income tax collected by the efforts of the tax department through assessment proceedings. The good thing about this is that most of the taxes collected, in fact almost all of them, are voluntarily paid by the taxpayers.

At this stage it is pertinent to point out that the rich store their wealth in property, currency and stocks. Immovable property is broadly not taxable under the constitution and unrealised gains arising on property and stocks are also not taxable. This means that the only tax that the rich pay on their wealth is the WHT on dividend and bank interest, which is a trivial 10% as compared to what salaried persons pay. Income tax on rental income may have been revised from the coming assessment year and the legislator has imposed a 0.5% tax on movable assets, but should the rich not pay taxes at a much higher rate than the rest?

There can be an argument that perhaps Sales tax is skewed towards the rich, unfortunately that is not the apparent case. Almost 41% of the sales tax in 2013 was collected from import and on domestic consumption of POL, the comparable percentage for 2008 is 36%. Since POL is generally used for transportation and generation of electricity, notwithstanding the subsidy on power, general consumers are worse off. By the way, sales tax as a proportion of total taxes has gone up to 44% in 2013 from 37.3% in 2008. Did anyone know that sales taxes collected on sugar, edible oil and fertiliser, which by default are used for the production of poor people's staple food, was a whopping Rs 52 billion? Compared to this sales tax collection on vehicles was a paltry Rs 20 billion.

As regards FED, more than 50% was collected on cigarettes. For the naïve, cigarettes are consumed by the masses, and while the rich may also indulge, they hardly pay taxes on imported smokes. The details on FED for 2008 are a bit unclear; nonetheless, FED on cigarettes was 32%. The balance of FED is mostly levied upon gas, services, cement, beverages and edible oil; so guess who is paying for that generally.

The expected final salvation of the system depended upon customs duty on vehicles, the play toys of the rich. Unfortunately, detailed breakdown

of customs duty for 2013 was not available. However, in 2008, customs duty on vehicles was again a measly Rs 26 billion, a mere 17% of the total custom duty collected in that year. On that basis, custom duty on vehicles cannot be more than Rs 29 billion in 2013. The rest of the custom duty is apparently mostly on POL and edible oil; unless things have changed radically in 2013.

The situation is definitely not encouraging, and the bad news is that based on this year's budget the primary thrust is again on indirect taxes. Note that every time POL prices are raised, the amount of sales tax and custom duty thereon increases in absolute terms, the government may be able to balance the budget through this seemingly innocuous strategy, but the poor end up paying more.

Finally, the mother of all taxes, inflation is uncontrollable. The rich's wealth, held in property, currency and stocks, is generally hedged against inflation and increases in valuation proportionately; unfortunately there is no known hedge for the poor's consumption. Something is not right outside of utopia as well! When will the rich ever pay taxes and how will income inequalities move towards a declining trend is perhaps an unsolvable mystery, democracy or otherwise. Clearly, the poor pay taxes either way.

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## Scotland

### IFS Assesses Tax options in an Independent Scotland

A new briefing note by the Institute of Fiscal Studies (IFS) says that the Scottish Government's unwillingness to introduce "politically difficult but much-needed" tax reforms, such as the revaluing of property for council tax purposes, "does not bode well" for an improved tax system in an independent Scotland.

The briefing note, entitled *Taxing an independent Scotland*, also describes the Scottish Government's assessment of the advantages of a 3 percent cut in corporation tax as "highly speculative."

A referendum on Scottish independence will be held in Scotland in September 2014, and the IFS says a "Yes" vote will be an opportunity to make "sensible changes" that the UK Government has failed to implement. As a starting point, the IFS refers to its 2011 *Tax By Design* document, which was the final report of the body's wide-ranging Mirrlees Review on tax reform and which argued in favor of what the IFS describes as "a progressive, neutral tax system."

However, the IFS judges that the reforms suggested in *Tax By Design* will need to be adjusted to reflect conditions in an independent Scotland. For example, a less unequal income distribution in Scotland means there is less need for redistribution via heavy income taxation, and less congested roads means there is less rationale for heavy motoring taxation.

Also, mobility between the two countries raises the likelihood of tax competition, and the IFS suggests that this will increase the pressure to raise taxation from immovable property. Instead, the IFS observes, Scotland "has been moving in the opposite direction, raising less of its revenue from property taxes by freezing council tax rates in cash terms."

The briefing also provides revenue amount and share estimates for a number of possible tax adjustments relating to income tax, National Insurance, VAT, council tax, and to fuel, alcohol, and tobacco duties. Referring back to previous IFS research, the body suggests that to match tax rises or spending cuts equivalent to those currently planned for the UK, extra measures amounting to GBP2.5bn at today's prices would be needed. A further GBP3.4bn will be needed to offset a decline in oil revenues, which is estimated to begin by 2017-18. – *Courtesy tax-news.com*

## **United Kingdom**

### **HMRC Accused of PAYE Coding Errors**

A member of the UK's Top 20 Group of chartered accountants claims that as many as one in three taxpayers who are liable for Pay As You Earn income tax may be paying the wrong amount, due to incorrect codes issued by HM Revenue and Customs.

UHY Hacker Young analyzed tax codes sent to its clients and found that around 37 percent were incorrect, meaning that their clients may have paid either too much or little income tax. According to Roy Maugham, who is a Partner at the firm's London office, mistakes were most frequently related to clients with several sources of income, such as income from an investment or from a large one-off dividend as well as their salary and benefits from their employer.

The firm cautions that the national figure may be less than 37 percent, due to the fact that that UHY Hacker Young's clients are more likely to have multiple income streams, but that many mistakes were basic. One office found in just one week examples of incorrect codes relating to 20 clients that disregarded liabilities created by employee benefits such as company cars and private health cover.

Maugham added that for those who may have underpaid tax, "it can be a shock to an individual's cash flow when HMRC moves to claw it back." He urged employers who provide benefits to double-check their employees' codes.

UHY Hacker Young has highlighted the problem of wrong tax codes previously. In May 2012 the firm found that up to a quarter of taxpayers with property or investment income may have been paying too much tax, with pensioners particularly vulnerable. – *Courtesy tax-news.com*

## **Germany**

### **Germany's Future Grand Coalition Unites on FTT**

German Chancellor Angela Merkel's Christian Democratic Union (CDU) party and the Social Democrats (SPD) have united on plans for a financial transactions tax (FTT), during ongoing Grand Coalition negotiations.

The CDU and SPD have reached an accord on plans to push through a FTT, negotiator Martin Schulz (SPD) explained

following a meeting of the “Europe and bank regulation” working group in Berlin.

Confirming the consensus, Markus Ferber of the CDU’s Bavarian sister party, the Christian Social Union (CSU), emphasized the parties’ commitment to ensuring that the tax is introduced quickly in the 11 European Union member states that have backed the plans, within the framework of enhanced cooperation. Ferber stressed that the black-red agreement is “a clear signal” that a Grand Coalition would pave the way for the tax to be implemented.

Marking significant and rapid progress, working group negotiators from both sides have agreed to press for the swift introduction of an FTT at European level, once a black-red coalition is in place. Both parties are in agreement that the tax should have a low rate and a wide base.

The European Commission’s FTT proposal provides for a 0.1 percent rate of tax to be levied on shares and bonds and for a 0.01 percent rate to be imposed on derivatives. Forecast to generate around EUR35bn (USD48.1bn), the tax is designed to ensure that the financial sector contributes to the costs of overcoming the crisis and to curb speculation. – *Courtesy tax-news.com*

## **Canada**

### **Canadian Tax Revenues up Year-On-Year**

Canadian tax revenues rose by CAD0.1bn (USD0.09bn) (0.6 percent) in August, helping to reduce the monthly deficit by CAD0.7bn.

Revenues reached CAD19.3bn, with personal, corporate, and non-resident income taxes all performing well. Personal income tax revenues rose by CAD0.3bn (2.6 percent), corporate tax revenues by CAD0.2bn (13.8 percent), and non-resident tax revenues by CAD0.1bn (17.2 percent).

On the other hand, excise taxes and duties were down CAD0.6bn (15.2 percent). Goods and services tax (GST) revenues also recorded a shortfall year-on-year, of CAD0.6bn (22 percent). Energy taxes, customs import duties and employment insurance (EI) premium revenues all recorded improvements on August, 2012.

Over the April to August period of the 2013-14 fiscal year, revenues rose by CAD2.3bn (2.2 percent) year-on-year, totalling CAD103.7bn. Personal income tax revenues increased by CAD1.2bn (2.3 percent) and non-resident income tax revenues by CAD0.3bn (12.8 percent). Corporate tax revenues underperformed by CAD0.3bn (2.4 percent.)

Excise taxes and duties fell by CAD0.1bn (0.7 percent), largely reflecting a CAD0.1bn decrease in revenues from other excise taxes and duties. GST revenues dropped by CAD12m, and energy taxes by CAD12m.

The 2012-13 Annual Financial Report of the Government of Canada shows that the deficit fell to CAD18.9bn. This figure is CAD7.4bn lower than that recorded in 2011-12 and is down by nearly two-thirds from 2009-10's CAD55.6bn deficit.

Finance Minister Jim Flaherty has said that the Government is focused on "helping create jobs and opportunities for Canadians; supporting hard-working families; helping keep our families and communities safe; and putting Canada first. Our Government continued efforts to ensure that every tax dollar is spent as efficiently as possible and that wasteful spending is eliminated are keeping Canada on track to balance the budget in 2015 without raising taxes or reducing important transfers to persons or to other levels of government." – *Courtesy tax-news.com*

## **Australia**

### **Australians Back Tax Avoidance Crackdown**

82 percent of Australians "strongly support" the introduction of regulations that would ensure the greater transparency of corporate profits and taxation payments, according to the results of a new survey.

Charity ActionAid quizzed 1,002 Australians at the start of this month on their attitudes towards corporate tax avoidance. 92 percent said that it is unacceptable that a foreign corporation should be able to operate in a country and pay no taxes there. 85 percent agreed that multinationals have a moral responsibility to pay their fair share of taxes in the developing countries in which they operate.

Roughly one in four (24 percent) consider tax avoidance to be a negative practice, describing it as "cheating" or "dodging." On the other hand, a pro-business sentiment was expressed by 51 percent

of those questioned – this group largely concluded that, when legal, tax avoidance is “good business practice.” 59 percent believe that the phrase “tax minimization” best describes corporate tax activities.

ActionAid claims that the survey demonstrates that Australian Prime Minister Tony Abbott has a clear mandate to crack down on tax avoidance when he takes over the presidency of the G20 in December. – *Courtesy tax-news.com*

**Inter-port cargo movement: FBR orders countywide audit of data**

The Federal Board of Revenue has ordered a countywide audit of data related to inter-port movement of cargo to verify whether all unclaimed containers are physically available at the ports or cleared illegally against fake Goods Declarations, causing revenue loss to the exchequer.

Sources told on Wednesday that the FBR wanted to ascertain the number of unclaimed containers removed illegally from ports following detection of 35 containers fraudulently cleared from Port Qasim Karachi. The case was detected by Directorate General of Customs Intelligence where 22 containers were unlawfully cleared from Port Qasim, Karachi from January 2013 to July 2013. Later, the number of such containers reached 35 after further investigation by the customs intelligence. In this regard, the FBR has issued instructions to all Model Customs Collectorate following detection made by the Directorate General of Customs Intelligence, sources said.

According to sources, the FBR has directed the field formations to carry out audit of data concerning inter-port movement of cargo for the last two years at least and also physically check the presence of unclaimed indices to see whether the goods were disposed of legally or otherwise. Details of the case revealed that the staff of Directorate General I&I-FBR, Regional Office, Karachi has detected unlawful clearance of twenty-two (22) 40 ft. containers imported at Port Qasim, Karachi during the period from January 2013 to July 2013. The theft of government revenue has been estimated to be Rs 9.46 million. However, more disturbing is the fact that the fraudsters were able to clear a huge number of consignments against fake and fabricated Goods Declarations.

Initially, two consignments were detected to have been clandestinely removed against fake GDs bearing Machine Nos. KPPI-HC-21132 dated 20.07.2012 and KPQI-HC-25192 dated 27.07.2013. Subsequently, twenty (20) more such cases were detected. The Directorate General's staff made extraordinary efforts to trace the truck drivers who were instrumental in transportation of the unlawfully cleared/clandestinely removed goods from the Port to the dumping places of the fraudsters. The FIR has been lodged in the case and one person has been arrested so far. An amount of Rs 5.4 million, involved in nine (09) of the twenty-two (22) consignments, has already been recovered out of

the total defrauded amount of Rs 9.46 million, hectic efforts are being made to recover the remaining amount. There are clear indications that further detections will also be made, sources said.

The investigation carried out so far has revealed that lack of supervision on the part of the Port Qasim officers/officials as well as some systemic fault lines have caused this loss to the Exchequer. In order to unearth and probe this failure the following action is proposed: A high-level committee consisting of three senior Customs officials be constituted, comprising DG Valuation, Director I&I Islamabad and Collector MCC-East Karachi, to ascertain the facts and fix responsibility on officials/officers for violating/non-implementing the procedures causing loss of revenue due to illegal removal of goods without payment of duty and taxes, sources said.

The Board has issued instructions to the collectorates to carry out audit of data of inter-port movement of cargo for the last two years at least, and also physically check the presence of unclaimed indices to see whether the goods were disposed of legally or otherwise, sources added. – *Courtesy Business Recorder*

### **Customs to target importers for recovery of short payments: 15 officials spared**

Instead of taking disciplinary action against 15 customs officials, who are involved in clearing consignments on wrong valuation rulings (VRs), the customs department is going to target only importers for the recovery of short payments, it is learnt on Wednesday.

According to sources, the Model Collectorate of Customs (MCC), Appraisement-West had conducted Post Release Verification (PRV) for the period July-September 2013, which revealed that notified valuation rulings were not applied in 73 cases by 15 assessing officers. The collectorate in its report said negligence/inefficiency of these officers caused a revenue loss of Rs 15 million.

Sources said the department had ordered these officers to recover the amount involved in those VRs till October 30, 2013 and if they failed to do so, disciplinary action would be taken against them under E&D Rules 1973. “Although no recovery of short payments has so far been made by these assessing officers from importers even after the lapse of October 30 deadline, the department

instead of squeezing the neck of its officials is planning to approach importers for recovery,” the sources said.

When contacted, Shahid Hussain Asad, official spokesman for the Federal Board of Revenue expressed his incognisance and refused to comment on it. Meanwhile, Muhammad Saleem, Collector MCC, Appraisalment-West said that Web Based One Customs, which had been lodged in July 2013, was a newly introduced clearance system and assessing officers were not familiar with it that led to the clearance of consignments on wrong VRs.

“The office order based on PRV is aimed at creating deterrence among the assessing officers to avoid this thing in future,” he said. Replying to a question, Saleem said, “Although the assessing officers had shown negligence in assessing VRs, importers are responsible as WeBOC was self-assessment system and they have put wrong VRs for the clearance of their consignments.” Moreover, Saleem said MCC, Appraisalment-West had commenced one-month training course for its officers to improve their efficiency and added that only those officers, who would qualify the post training test, would be posted in assessment hall to avert such happening in future. – *Courtesy Business Recorder*

### **New customs values for facial tissue papers fixed**

Directorate General of Customs Valuation Karachi has determined and issued new customs values, ranging between \$1.72 per kg to \$2.44 per kg, on the import of facial tissue papers from China, Malaysia and UAE. It is learnt on Wednesday that the Directorate General of Customs Valuation Karachi has issued a valuation ruling to check under-invoicing on the import of facial tissue paper in exercise of the powers conferred under section 25-A of the Customs Act, 1969.

Under the new ruling, a reference was received from MCC (Appraisalment), East, Karachi regarding under-invoicing in the import of facial tissue paper, on the basis of an original invoice found in a consignment imported from UAE. Therefore, an exercise to determine the Customs values of the subject good was initiated. The valuation methods given in section 25 of the Customs Act, 1969 were followed. Transaction value method provided in subsection (1) of section 25 was found inapplicable because the requisite information was not available. Identical/ similar goods value methods provided in sub-section (5) & (6) of section 25 were examined for applicability to the valuation issue in the instant

case which could not be applied due to unreliable and variable values. Market enquiry as envisaged under sub-section (7) of section 25 was conducted and values so worked-back were taken up for value determination. Consequently, Deductive value method provided under subsection (7) of section 25 of the Customs Act, 1969, was applied to arrive at the Customs value of Facial Tissue Paper.

Stakeholders' participation in determination of Customs value: A meeting was fixed with stakeholders to discuss the current international values of facial tissue paper but no one appeared. The customs values for facial tissue paper shall be assessed to duty/taxes for different origins at the specified customs values.

In cases where declared values are higher than the Customs value determined in this Ruling, the assessing officers shall apply those values in terms of sub-section (1) of section 25 of the Customs Act, 1969. In case of consignments imported by air, the assessing officer shall take into account the differential between air freight and sea freight while applying the Customs values determined in this ruling.

The values determined vide this ruling shall be the applicable Customs value for assessment of subject imported goods until and unless it is rescinded or revised by the competent authority in terms of sub-sections (1) or (3) of section 25 of the Customs Act, 1969. A review petition may be filed against this Ruling, as provided under Section 25-D of the Customs Act, 1969, within 30 days from the date of issue, before the Director General, Directorate General of Customs Valuation, Karachi. The Collectors of Customs may ensure that the values given in the Ruling are applied by the concerned staff without fail, the ruling added. –  
*Courtesy Business Recorder*

### **Modaraba management companies: SHC restrains collection of sales tax**

While hearing a petition challenging the validity of sales tax on profits of modaraba management companies, Sindh High Court has restrained Sindh Revenue Board from collecting sales tax on profits of all modaraba management companies.

Representing the petitioners NBF and Modaraba Association of Pakistan and also 12 separate modaraba management companies, Advocate Saim Hashmi of Ahmed & Qazi, argued before the Court

that as modaraba management companies do not provide any 'services' and are thus out of the purview of Sindh Sales Tax on Services Act 2011, no 'sales on services' could be collected from them.

A divisional bench of SHC comprising Justice Hassan Azhar Rizvi and Justice Junaid Ghaffar passed the restraining order after hearing the stay application, directing Sindh Revenue Board not to take any coercive action against modaraba management companies for collection of sales tax.

Earlier, Sindh Revenue Board (SRB) had issued demand notices to all the modaraba management companies for the recovery of sales tax on their profits under tariff heading No 9813 and 9824 of first schedule of Sindh Sales Tax on Services Act 2011 which led to the Association and modaraba management companies to file the said petition before the Court challenging the vires of the above given tariff headings of Sindh Sales Tax on Services Act 2011? The court directed SRB to furnish its parawise comments to the Petition within 10 days time. – *Courtesy Business Recorder*

### **Recommendations to curb tax evasion in FBR**

To curb tax evasion in Federal Board of Revenue (FBR) and make it a department of "Zero tolerance against corruption", and further to plug estimated tax leakage of Rs 2,000 billion per annum, Transparency International Pakistan has submitted its recommendations to the Supreme Court, in accordance with the orders given by the Chief Justice of Pakistan on October 29.

The recommendations submitted by Adviser TI-Pakistan, Syed Adil Gilani have been divided into three sections, ie A-Customs, B-income tax, and C-sales tax:

**A-CUSTOMS:** It has been suggested that out sourcing of the valuation of imports, to third party be adopted and recommendations of Federal Tax Ombudsman (FTO) ( Dr Muhammad Shoaib Suddle) Commission Report of January 10, 2011, on page 68, shall be implemented. Other recommendations relate to: admin measures, technical measures, risk management of containers, transportation of containers, en route monitoring, and receipt of containers at border customs-stations, legal measures, midterm measures, and long term measures.

**B-INCOME TAX:** 1. The Professionals are known normally for not paying income tax on their real income earned from practice, from

non public sector clients. Architects, consulting engineers, doctors, lawyers, mostly take their fees in cash from private persons, and most of the time even from businessmen/companies. FBR should device mechanism to monitor these professional, to collect real tax.

2. Real Estate (Land/houses/ shops/flats) is valued at FBR determined collector's rates, which is not even 10 percent of the real market value. Government levies in registering of the sale, are in the range of 3 to 7 percent, depending from province to province. Black money is accumulated for the genuine seller, and corruption and tax evaded money is invested in the real estate. This is a state generated black economy system.

The government levies in registering of the sale shall therefore be reduced to 0.5 percent-1 percent. In order to eliminate undervalued sale price of property, the FBR shall be allowed to buy the property at the price on which seller is registering the sale. By taking this measure, FBR (WHT) and provincial revenue will increase, and the black money hide out in real estate will be eliminated.

3. CNIC shall be declared as NTN number, and all citizens shall be made to file IT Return, even at zero income. FBR shall facilitate those who can not file IT Returns all over Pakistan. All sale/purchase transitions above Rs 10,000 shall be made through cross cheques, and FBR e-portal shall be made effective to register all transitions in Pakistan. Nadra may be entrusted to prepare software for FBR for this purpose, within a defined period, say three months.

4. WHT deducted/paid (at present it is 3.5 percent to 6 percent) shall be made final, on all professionals and contractors and suppliers.

5. Law shall be made to declare "tax evasion" as a crime against state and punishments be awarded by courts within a defined period, say 90 days.

6. FBR declared in 2012 that its has data of 3.8 million, who are not paying income tax, and spending millions of rupees, for which a tax amnesty scheme was proposed, which did not materialise. FBR should collect tax from these 3.8 million tax evaders.

**C-SALES TAX:** General Sales Tax at FBR level: major corruption is in

- a. Refund of sales tax.
- b. Adjustment of sales tax.

These two are the major source of corruption and sales tax evasion. High rate of sales tax is applicable at each stage, from import custom, raw material sales, various stages of manufacturing, and finally at retail sales. As a policy FBR should abolish adjustments and refund.

As an example at each stage an average 16 percent sales tax is payable, major share is paid through adjustments of sales tax paid on the previous stage. The adjustments of sales tax paid at previous stage are allowed which is the major source of corruption. Best solution is to finish the concept of adjustments/refund by imposing nominal rate of sales tax at each and every stage without any adjustment /refund from previous stage. This will reduce corruption to minimal levels as 0.5- 1.5 percent sales tax at every step will have no incentive for sales tax evasion.

The concept of “flying invoices” and “adjustment/ refund” will become non attractive. This system must be imposed both for industry and importers.

If FBR makes irrevocable policy of no refunds no adjustments total GST leakages by frauds/ evasions, will be stopped.

**FINALLY TI-PAKISTAN HAS RECOMMENDED FOLLOWING MEASURES:**

- a. In case of appeal, litigation against FBR assessments National Saving Certificates shall be deposited by the litigant, in the court.
- b. In case the court overturns the FBR assessment, strict administrative action shall be taken against the officer of FBR for imposing wrong tax. This step will eliminate the harassment (for taking bribe) alleged to be the main purpose of making the false assessments by FBR officers.
- c. In case for custom dues, any party does not pay the taxes, nor make any appeal, the imported goods shall be auctioned within one week time, after expiry of the allowed period to pay.
- d. In case of any FBR tax defaults, courts shall announce judgements within 90 days. – *Courtesy Business Recorder*

2013 TRI 1785 (S.C. Ind.)

SUPREME COURT OF INDIA

**K.S. Radhakrishnan and A.K. Sikri, JJ.**

*MAK Data P. Ltd.*

*v.*

*Commissioner of Income Tax-II*

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**FACTS/HELD**

**Under Explanation 1 to section 271(1)(c), voluntary disclosure of concealed income does not absolve assessee of s. 271(1)(c) penalty if the assessee fails to offer an explanation which is bona fide and proves that all the material facts have been disclosed**

1. The assessee filed a return of income for AY 2004-05 declaring an income of Rs.16 lakhs. During the course of the assessment proceedings, the AO noticed certain documents comprising of share application forms, bank statements, blank share transfer deeds etc had been impounded in the course of s. 133A survey proceedings conducted in the case of the assessee's. The AO sought specific information regarding the documents from the assessee. In reply to the show-cause notice, the assessee made an offer to surrender Rs.40.74 lakhs with a view to avoid litigation and buy peace and to make an amicable settlement of the dispute. The AO assessed the said sum of Rs.40.74 lakhs to tax and levied penalty u/s 271(1)(c) for concealment of income and not furnishing true particulars. This was upheld by the CIT(A) though the Tribunal reversed it on the ground that the surrender was without admitting any concealment. On appeal by the department, the High Court (87 DTR 172 (Del)) reversed the Tribunal on the ground that as there was absolutely no explanation by the assessee for the concealed income of Rs.40.74 lakhs, the first part of clause (A) of Explanation 1 to s. 271(1)(c) is attracted. On appeal by the assessee to the Supreme Court HELD dismissing the appeal:

- (i) The Tribunal has not properly understood or appreciated the scope of Explanation 1 to s. 271(1)(c). The AO shall not be carried away by the plea of the assessee like

“voluntary disclosure”, “buy peace”, “avoid litigation”, “amicable settlement”, etc. to explain away its conduct. The question is whether the assessee has offered any explanation for concealment of particulars of income or furnishing inaccurate particulars of income. Explanation to s. 271(1) raises a presumption of concealment, when a difference is noticed by the AO, between reported and assessed income. The burden is then on the assessee to show otherwise, by cogent and reliable evidence. When the initial onus placed by the explanation, has been discharged by him, the onus shifts on the Revenue to show that the amount in question constituted the income and not otherwise;

- (ii) The assessee has only stated that he had surrendered the additional sum of Rs.40.74 lakhs with a view to avoid litigation, buy peace and to channelize the energy and resources towards productive work and to make amicable settlement with the income tax department. The statute does not recognize those types of defences under Explanation 1 to s. 271(1)(c) of the Act. It is trite law that the voluntary disclosure does not release the assessee from the mischief of penal proceedings. The law does not provide that when an assessee makes a voluntary disclosure of his concealed income, he had to be absolved from penalty;
- (iii) On facts, the surrender of income is not voluntary in the sense that the offer of surrender was made in view of detection made by the AO in the search conducted in the sister concern of the assessee. In that situation, it cannot be said that the surrender of income was voluntary. AO during the course of assessment proceedings has noticed that certain documents comprising of share application forms, bank statements etc have been impounded in the course of survey proceedings u/s 133A conducted in the case of the assessee's sister concern. The survey was conducted more than 10 months before the assessee filed its return of income. Had it been the intention of the assessee to make full and true disclosure of its income, it would have filed the return declaring an income inclusive of the amount which was surrendered later during the

course of the assessment proceedings. Consequently, it is clear that the assessee had no intention to declare its true income;

- (iv) It is the statutory duty of the assessee to record all its transactions in the books of account, to explain the source of payments made by it and to declare its true income in the return of income filed by it from year to year. The AO has recorded a categorical finding that he was satisfied that the assessee had concealed true particulars of income and is liable for penalty proceedings u/s 271 read with s. 274 of the Act;
- (v) The AO has to satisfy himself whether penalty proceedings be initiated or not during the course of the assessment proceedings. He is not required to record his satisfaction in a particular manner or reduce it into writing. The scope of s. 271(1)(c) has also been elaborately discussed by the Supreme Court in UOI vs. Dharmendra Textile Processors 306 ITR 277 (SC) and CIT vs. Atul Mohan Bindal 317 ITR 1 (SC). The principle laid down by this Court has been correctly followed by the Revenue and there is no illegality in the department initiating penalty proceedings in the instant case.

*Appeal dismissed.*

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**Civil Appeal No. 9772 of 2013 (Arising out of Special Leave Petition (Civil) No.18389 of 2013)**

**Decided on: 30<sup>th</sup> October, 2013.**

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### **JUDGMENT**

*K.S. Radhakrishnan, J.–*

1. Leave granted.

2. The Appellant-assessee filed his return of income for the assessment year 2004-05 on 27<sup>th</sup> October, 2004, declaring an income of Rs.16,17,040/- along with Tax Audit Report. The case was selected for scrutiny and notices were issued under Sections 143(2) and 142(1) of the Income Tax Act. During the course of the assessment proceedings, it was noticed by the Assessing Officer (AO) that certain documents comprising of share application forms, bank statements, memorandum of association of companies, affidavits, copies of Income Tax Returns and assessment orders and blank share transfer deeds duly signed had been impounded. These documents had been found in the course of survey proceedings under Section 133A conducted on 16.12.2003 in the case of M/s Marketing

Services (a sister concern of the assessee). The AO then proceeded to seek information from the assessee and issued a show-cause notice dated 26.10.2006. By the show-cause notice, the AO sought specific information regarding the documents pertaining to share applications found in the course of survey, particularly, bank transfer deeds signed by persons, who had applied for the shares. Reply to show-cause notice was filed on 22.11.2006, in which the assessee made an offer to surrender a sum of Rs.40.74 lakhs with a view to avoid litigation and buy peace and to make an amicable settlement of the dispute. Following are the words used by the assessee:—

“The offer of surrender is by way of voluntary disclosure of without admitting any concealment whatsoever or with any intention to conceal and subject to non-initiation of penalty proceedings and prosecution.”

3. The AO after verifying the details and calculations of the share application money accepted by the Company completed the assessment on 29.12.2006 and a sum of Rs.40,74,000/- was brought to tax, as “income from other sources” and the total income was assessed at Rs.57,56,700/-.

4. The department initiated penalty proceedings for concealment of income and not furnishing true particulars of its income under Section 271(1)(c) of the Income Tax Act. During the course of the hearing, the assessee contended that penalty proceedings are not maintainable on the ground that the AO had not recorded his satisfaction to the effect that there has been concealment of income/furnishing of inaccurate particulars of income by the assessee and that the surrender of income was a conditional surrender before any investigation in the matter. The AO did not accept those contentions and imposed a penalty of Rs.14,61,547/- under Section 217(1)(c) of the Act. The assessee challenged that order before the Commissioner of Income Tax (Appeals) by filing Appeal No.2/07-08, which was dismissed vide order dated 17.2.2010. The assessee filed an appeal being ITA No.1896/Del/10 before the Income Tax Appellate Tribunal, Delhi. The Tribunal recorded the following findings:—

“The assessee’s letter dated 22.11.2006 clearly mentions that “the offer of the surrender is without admitting any concealment whatsoever or any intention to conceal.”

The Tribunal took the view that the amount of Rs.40,74,000/- was surrendered to settle the dispute with the department and since the assessee, for one reason or the other, agreed or surrendered certain amounts for assessment, the imposition of penalty solely on the basis of assessee’s surrender could not be sustained. The Tribunal, therefore, allowed the appeal and set aside the penalty order.

5. The Revenue took up the matter in appeal before the High Court by filing ITA No.415 of 2012. The High Court accepted the plea of the Revenue that there was absolutely no explanation by the assessee for the

concealed income of Rs.40,74,000/-. The High Court took the view that in the absence of any explanation in respect of the surrendered income, the first part of clause (A) of Explanation 1 is attracted. Holding so, the judgment of the Tribunal was set aside and the appeal filed by the Revenue was allowed.

6. We have heard counsel on either side. We fully concur with the view of the High Court that the Tribunal has not properly understood or appreciated the scope of Explanation 1 to Section 271(1)(c) of the Act, which reads as follows:—

“Explanation 1 – Where in respect of any facts material to the computation of the total income of any person under this Act,—

- (A) Such person fails to offer an explanation or offers an explanation which is found by the Assessing Officer or the Commissioner (Appeals) or the Commissioner to be false, or
- (B) Such person offers an explanation which he is not able to substantiate and fails to prove that such explanation is bona fide and that all the facts relating to the same and material to the computation of his total income have been disclosed by him, then the amount added or disallowed in computing the total income of such person as a result thereof shall, for the purposes of clause (c) of this sub-section, be deemed to represent the income in respect of which particulars have been concealed.”

7. The AO, in our view, shall not be carried away by the plea of the assessee like “voluntary disclosure”, “buy peace”, “avoid litigation”, “amicable settlement”, etc. to explain away its conduct. The question is whether the assessee has offered any explanation for concealment of particulars of income or furnishing inaccurate particulars of income. Explanation to Section 271(1) raises a presumption of concealment, when a difference is noticed by the AO, between reported and assessed income. The burden is then on the assessee to show otherwise, by cogent and reliable evidence. When the initial onus placed by the explanation, has been discharged by him, the onus shifts on the Revenue to show that the amount in question constituted the income and not otherwise.

8. Assessee has only stated that he had surrendered the additional sum of Rs.40,74,000/- with a view to avoid litigation, buy peace and to channelize the energy and resources towards productive work and to make amicable settlement with the income tax department. Statute does not recognize those types of defences under the explanation 1 to Section 271(1)(c) of the Act. It is trite law that the voluntary disclosure does not release the Appellant-assessee from the mischief of penal proceedings. The law does not provide that when an assessee makes a voluntary disclosure of his concealed income, he had to be absolved from penalty.

9. We are of the view that the surrender of income in this case is not voluntary in the sense that the offer of surrender was made in view of detection made by the AO in the search conducted in the sister concern of the assessee. In that situation, it cannot be said that the surrender of income was voluntary. AO during the course of assessment proceedings has noticed that certain documents comprising of share application forms, bank statements, memorandum of association of companies, affidavits, copies of Income Tax Returns and assessment orders and blank share transfer deeds duly signed, have been impounded in the course of survey proceedings under Section 133A conducted on 16.12.2003, in the case of a sister concern of the assessee. The survey was conducted more than 10 months before the assessee filed its return of income. Had it been the intention of the assessee to make full and true disclosure of its income, it would have filed the return declaring an income inclusive of the amount which was surrendered later during the course of the assessment proceedings. Consequently, it is clear that the assessee had no intention to declare its true income. It is the statutory duty of the assessee to record all its transactions in the books of account, to explain the source of payments made by it and to declare its true income in the return of income filed by it from year to year. The AO, in our view, has recorded a categorical finding that he was satisfied that the assessee had concealed true particulars of income and is liable for penalty proceedings under Section 271 read with Section 274 of the Income Tax Act, 1961.

10. The AO has to satisfy whether the penalty proceedings be initiated or not during the course of the assessment proceedings and the AO is not required to record his satisfaction in a particular manner or reduce it into writing. The scope of Section 271(1)(c) has also been elaborately discussed by this Court in *Union of India vs. Dharmendra Textile Processors* (2008) 13 SCC 369 and *CIT vs. Atul Mohan Bindal* (2009) 9 SCC 589.

11. The principle laid down by this Court, in our view, has been correctly followed by the Revenue and we find no illegality in the department initiating penalty proceedings in the instant case. We, therefore, fully agree with the view of the High Court. Hence, the appeal lacks merit and is dismissed. There shall be no order as to costs.

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