



SPECIAL AUDIT REPORT
ON
SELECTED INLAND REVENUE
WAREHOUSES OF
FEDERAL BOARD OF REVENUE
AUDIT YEAR 2022-23

AUDITOR-GENERAL OF PAKISTAN

PREFACE

Articles 169 and 170 of the Constitution of the Islamic Republic of Pakistan, 1973 read with Sections 8 and 12 of the Auditor-General's (Functions, Powers and Terms and Conditions of Service) Ordinance, 2001 require the Auditor-General of Pakistan to conduct audit of expenditure and receipts of Government of Pakistan.

The report is based on Special audit of Selected Inland Revenue Warehouses which was conducted on the request of Chairman FBR. The Directorate General Audit, Inland Revenue and Customs, Lahore, carried out the aforesaid special audit with a view to report significant findings as requested by the auditee. The audit team examined the record of the warehouses to ascertain proper inventory controls applied in maintaining warehouses and compliance of regulatory regime of the goods. In addition to the scope defined by the Auditee, the Directorate also explored the reason(s) which led to confiscation of the items stored in the warehouses.

Audit observations included in this report have been finalized in the light of departmental replies and discussions in DAC meeting held in January, 2024.

The Special Audit Report is submitted to the President of Pakistan in pursuance of the Article 171 of the Constitution of the Islamic Republic of Pakistan, 1973 for causing it to be laid before both Houses of the Majlis-e-Shoora [Parliament].

Islamabad
Dated: 26 September 2024

(Muhammad Ajmal Gondal)
Auditor-General of Pakistan

TABLE OF CONTENTS

	Page #
ABBREVIATIONS & ACRONYMS	i
EXECUTIVE SUMMARY	iii
1 INTRODUCTION	1
2 AUDIT OBJECTIVES	3
3 AUDIT SCOPE AND METHODOLOGY	3
4 AUDIT FINDINGS AND RECOMMENDATIONS	3
4.1 ORGANIZATION AND MANAGEMENT	4
4.2 FINANCIAL MANAGEMENT	10
4.3 OVERALL ASSESSMENT	13
5 CONCLUSION	16
ACKNOWLEDGMENT	17
Annexures	18

ABBREVIATIONS & ACRONYMS

AJK	Azad Jammu & Kashmir
NDP	Non-Duty Paid
FBR	Federal Board of Revenue
FED	Federal Excise Duty
FIA	Federal Investigation Agency
GLT	Green Leaf Threshers
IB	Intelligence Bureau
IR	Inland Revenue
IREN	Inland Revenue Enforcement Network
I&I	Inspection & Intelligence
IPSOS	Institute Public de Sondage d'Opinion Secteur
KTC	Khyber Tobacco Company
LEA	Law Enforcement Agency
MNHSRC	Ministry of National Health Services Regulation & Coordination
MLO	Martial Law Order
RTO	Regional Tax Office
TTS	Track and Trace System
UIMs	Unique Identification Markers

EXECUTIVE SUMMARY

Directorate General of Audit Inland Revenue & Customs, Lahore conducted Special Audit of selected Inland Revenue warehouses on the request of Chairman FBR during the Audit Year 2022-23. The main purpose of special audit was to ensure the application of government rules and regulations in maintaining the inventory in the warehouses. These warehouses contained non-duty paid/counterfeit (brands) cigarettes which had been confiscated/seized. The seized cigarettes were neither auctioned to affect recovery of the government revenue nor destroyed, therefore, the scope of audit was expanded beyond warehouses to explore the reason(s) for the confiscation of the cigarettes.

It was found that failure to control the trade of these goods not only reduced government revenue but also distorted the market for legal taxpayers. Survey by a research think-tank IPSOS indicate an increase in the share of smuggled and non-duty paid cigarettes in the total cigarette market of Pakistan after the FED hike by Federal Government in February, 2023. The Audit found that main reasons for increase in the incidence of illicit trade of cigarettes were lax border control and weak local enforcement. This was evident in the lackluster performance of the Directorate of I&I and Inland Revenue Enforcement Network (IREN) squads. The enforcement was limited to suppliers while no action was initiated against the manufacturers primarily because of jurisdictional limitations. Moreover, a lack of coordination and unified response in the enforcement activities was observed which led to confiscation and long-drawn legal proceedings thereafter.

A. Key findings of the audit report

- a) Non-duty paid cigarettes were kept in the warehouses in dilapidated condition for a long period of time. These goods were neither auctioned to recover the due tax nor were destroyed in public interest to clear the occupied space to be used for other constructive purposes. No periodic inspection was held by the department for stock taking of the goods confiscated to ensure better controls. (Para 4.1.1)
- b) Performance of the Directorate of I&I and Inland Revenue Enforcement Network in curbing illicit trade was below par. RTOs

on an average conducted only 01 successful raid per month, except for RTO Peshawar which conducted 04 raids per month. (Para 4.1.2)

- c) Enforcement function of FBR was disorganized and failed to monitor the whole supply chain including Green Leaf Threshers (GLTs) and imported raw material. Lax border control coupled with limitations imposed by territorial jurisdiction led to enforcement which was limited to distributors and traders only. FBR was also not able to implement the Minimum Retail Price of cigarette in the market, due to which non-duty paid cigarettes flooded the market. (Para 4.1.3)
- d) The implementation of Track and Trace System (TTS) in tobacco sector was stalled because of litigation. Only 03 out of 40 registered manufacturers had been enrolled in the TTS so far. (Para 4.1.4)
- e) Confiscated cigarettes stored in the warehouses involving FED and sales tax amounting to Rs 116 million could not be disposed of timely. No one approached the authorities for possession of confiscated cigarettes and the same could not be auctioned being counterfeit and injurious to health. RTOs lacked uniform operating procedures and timelines for destruction of counterfeit items. (Para 4.2.1)
- f) Adjudged government revenue of Rs 53 million was not recovered from the defaulters. (Para 4.2.2)
- g) Illicit trade in tobacco sector resulted in potential losses of Rs 240 billion due to weak enforcement and lax border control. (Para 4.3.1)

Recommendations

- a) The Audit recommends strengthening the enforcement function through incentives linked with performance appraisal. The federal government should implement strict border controls to decrease the incidence of smuggling from Afghanistan and Iran.
- b) The whole supply chain of tobacco products be closely monitored under the track and trace system. Raw materials like imported filter rods and their raw materials need to be strictly controlled to ensure traceability. Production data of Green Leaf Threshers needs to be monitored through special implementation teams and matched with industrial output for

gaining better insight into the operations of tobacco industry and to identify leakages.

- c) The Track and Trace System should be coupled with strong monitoring measures to increase revenue collection.
- d) Enforcement should be strengthened through integrated intelligence networks which include all stakeholders i.e. FBR, local law enforcement agencies, provincial Excise Departments, FIA, IB, and industry representatives. Smuggling of goods from non-tariff to tariff areas especially from AJK should be controlled through strategically located check posts.
- e) Adjudged government revenue should be recovered expeditiously. The subjudice cases may be expedited under the relevant laws to cut holding costs and clear storage space for other purposes.
- f) The audit recommends instituting an internal audit mechanism for monitoring these warehouses. Further, proper warehouse buildings should be constructed in line with the international standards and a separate wing under the supervision of the respective Chief Commissioner should be established for monitoring all the activities ancillary with the warehouses. Moreover, an inquiry for inaction by the management for non-disposal of confiscated goods may be initiated.
- g) Anti-smuggling powers should not be delegated by the Customs authorities to establish a clear line of accountability. Local enforcement through raids on identified hotspots (**Annex-A**) be planned and executed with the help of local law enforcement agencies. Incentives for enforcement activity like cash rewards, designated uniforms and logistics may be provided to IREN officers/officials for improving performance.

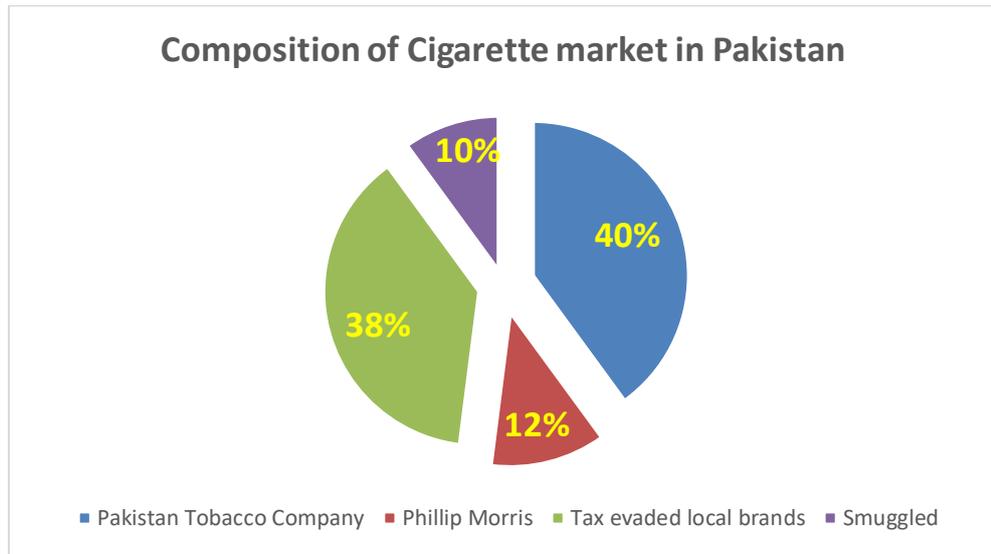
1. INTRODUCTION

The Chairman FBR requested the Auditor-General of Pakistan to conduct Special audit of selected Inland Revenue warehouses to ensure the application of rules and regulations. Directorate General of Audit Inland Revenue and Customs, Lahore conducted the Special Audit to ensure that proper controls are applied in maintaining inventory of the goods stored therein. However, the audit also expanded the scope of the audit to intimate the management by giving suitable recommendations on weak areas so that the management could identify the reason(s) behind the confiscation of goods and get assurance that legal proceedings were initiated timely and effectively to safeguard the government revenue.

The audit is of the opinion that the inspection and monitoring of warehouses should be a year-round activity appropriately performed by the department. The information provided by FBR was no longer relevant as the inventory of these warehouses changed by the time the external Audit planned and executed the exercise. The audited warehouses mostly contained counterfeit/non-duty-paid cigarettes, therefore, this led the audit to explore the illicit trade of cigarettes in detail.

Illicit tobacco trade refers to any practice related to distributing, selling, or buying tobacco products prohibited by law, including local tax evasion, counterfeiting, disguising the origin of products, and smuggling. Illicit tobacco trade is a multi-dimensional issue globally because of inter-linked implications on revenue, health and crime. According to IPSOS Pakistan¹ the share of various players in the cigarette' market of Pakistan is depicted in the following pie chart:

¹ Market assessment of illicit Cigarette Brands In Pakistan, IPSOS Pakistan, May 2023



According to the Oxford Economics data 2020, illegal cigarettes accounted for 37.6% of total consumption in Pakistan. The total amount of tax evaded by illegal cigarettes in Pakistan in 2019-20 was Rs 77.3 Billion. According to the 2021 report by IPSOS Global, there are five major sectors where the tax evasion ratio is high. The sectors include Tea, Tobacco, Tyres & Auto Lubricants, Pharmaceutical and Real Estate. According to local surveys, the share of illicit cigarette trade in Pakistan is recorded at around 18 percent². High FED in two tiers 56%-183% was imposed on local brands of cigarettes in addition to a minimum retail price of Rs 120. This has resulted in increased tax evasion in tobacco sector of Pakistan.

Under the Sales Tax General Order 07/2021, existing and new manufacturers were required to register all their brands. The scope of the law also included Azad Jammu and Kashmir, but so far only 16 brands had been registered under the law. Only three (03) out of forty (40) companies registered with the Pakistan Tobacco Board had installed the track and trace system which became operational from 1st July 2022. FBR directed to all cigarette manufactures to close cigarette production without tax stamps from 1st July, 2022. Nine (09) cigarette manufacturers challenged the FBR’s decision in court but currently there is no litigation pending in courts³.

²<https://www.nation.com.pk/22-May-2023/illicit-cigarettes-trade-remains-18-percent-in-pakistan>; accessed on 12 November, 2023

³<https://www.brecorder.com/news/40188337>; accessed on 12 November, 2023

2. AUDIT OBJECTIVES

In view of the specification of the special audit, the major objectives were to ensure whether: -

- i. the quantity of the confiscated goods was the same as reported by FBR;
- ii. appropriate and sufficient controls were applied to trace illicit trade of non-duty paid goods;
- iii. assessment of the duties and taxes on confiscated goods were made under relevant tax laws;
- iv. legal proceedings were finalized to ensure early recovery of government revenue;
- v. the counterfeit goods were disposed of under the existing legal framework;
- vi. the government revenue was protected;
- vii. the internal controls were in place to monitor production and clearance of goods after assessment and payment of duty and taxes; and
- viii. the trace and track system had been implemented.

3. AUDIT SCOPE AND METHODOLOGY

The audit was limited to the field formations where IR warehouses were situated. The audit methodology involved data collection, analysis, physical inspection, discussions with the management, and literature review. Afterwards, an analysis was performed in view of the scope of the audit. The main purpose of special audit was to ensure the application of government rules and regulations in maintaining the inventory in the warehouses. These warehouses contained non-duty paid/counterfeit (brands) cigarettes which had been confiscated/seized. The seized cigarettes were neither auctioned to affect recovery of the government revenue nor destroyed, therefore, the scope of audit was expanded beyond warehouses to explore the reason(s) for the confiscation of the goods cigarettes.

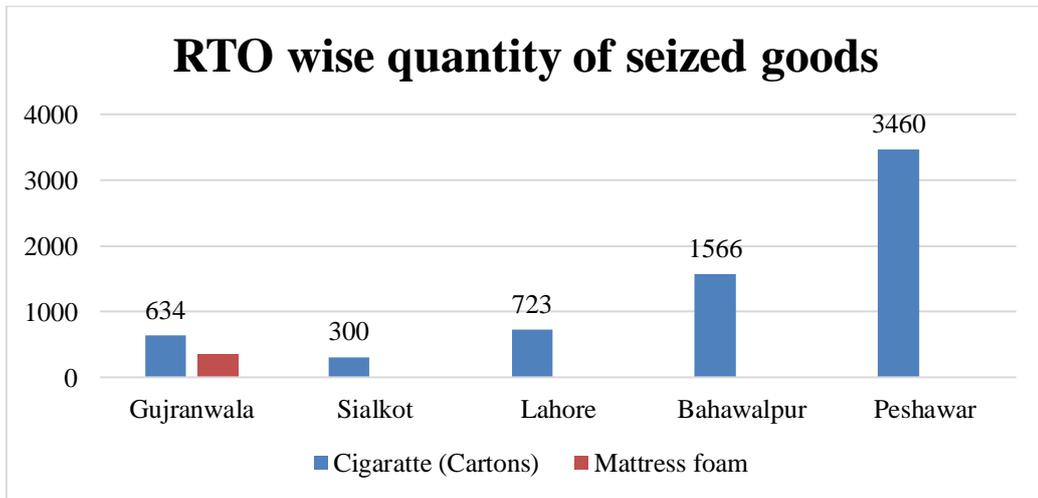
4. AUDIT FINDINGS AND RECOMMENDATIONS

This report includes audit observations on organization and management, weaknesses and key issues of financial management having a revenue impact of Rs 188 million in illustrative cases and an overall assessment of IR warehouses. Audit also made recommendations keeping in view the audit findings reported therein.

4.1 ORGANIZATION AND MANAGEMENT

The Federal Board of Revenue (FBR) is responsible for collecting and preventing evasion/avoidance of various taxes, including income tax, sales tax, federal excise and customs duty.

FBR has been empowered to impose checks over the trading of non-duty/taxes paid goods within a Province and between Provinces to safeguard government revenue. Director General of Broadening of Tax Base FBR was renamed as Director General, Directorate of Intelligence & Investigation, Inland Revenue on 25th March, 2011. The Directorates of I&I are authorized to confiscate non-duty paid goods. After confiscation, the seized goods are kept in designated warehouses known as IR warehouses. These confiscated items are either auctioned or destroyed depending upon the nature of the goods. Commissioners have been empowered to decide and act accordingly. Warehouses are situated at RTO Gujranwala, Lahore, Sialkot, Peshawar and Bahawalpur.



Source: - Chairman FBR's letter dated 02.02.2022)

The above graph shows a comparison of total stock at different RTOs as reported by the Chairman FBR. The highest stock was present in RTO Peshawar whereas lowest stock was present at RTO Sialkot. Only RTO Gujranwala had 'Mattress foams' in addition to cigarettes.

4.1.1 Improper application of controls in maintaining inventory in warehouses

Rule 66 of Federal Excise Rules, 2005 provides that when anything is confiscated under the Federal Excise Act, 2005 or these rules, such thing shall thereupon vest in the Government and the officer adjudging confiscation shall take and hold possession of the thing confiscated, and every officer of Federal Excise or of Police, on the requisition of such officer, shall assist him in taking and holding such possession. Articles of which confiscation has been adjudged and in respect of which the option of paying a penalty in lieu of confiscation has not been exercised, shall be sold, destroyed or otherwise disposed of in such manner as the Collector may direct.

Audit observed, during audit of selected warehouses, that the quantity stored in the warehouses was reconciled with the quantity reported by the auditee organization. The Audit, however, noted the following discrepancies in maintaining the inventory kept in the warehouses: -

- i. The non-duty paid/counterfeit cigarettes had to be kept in the warehouses with proper ventilation to keep the goods undamaged. However, audit observed that proper warehouse buildings had not been constructed, rather portions of office buildings were reserved without any ventilation.
- ii. The goods confiscated were neither destroyed nor disposed of for a long period of time. Therefore, these items occupied the office premises unnecessarily which could be used for some other purposes by the department.
- iii. No periodic inspection had been scheduled by the department for stock taking of the goods confiscated to ensure that the goods are not damaged/stolen.

Hence, Audit concluded that due to above mentioned facts, confiscated goods were unnecessarily kept in the warehouses without required ventilation for a long period of time showing weak internal controls leading to loss of revenue to public exchequer.

Audit recommends following remedial measures:

- a. time bound monitoring activities of the warehouses should be designed in a way to keep the goods safe

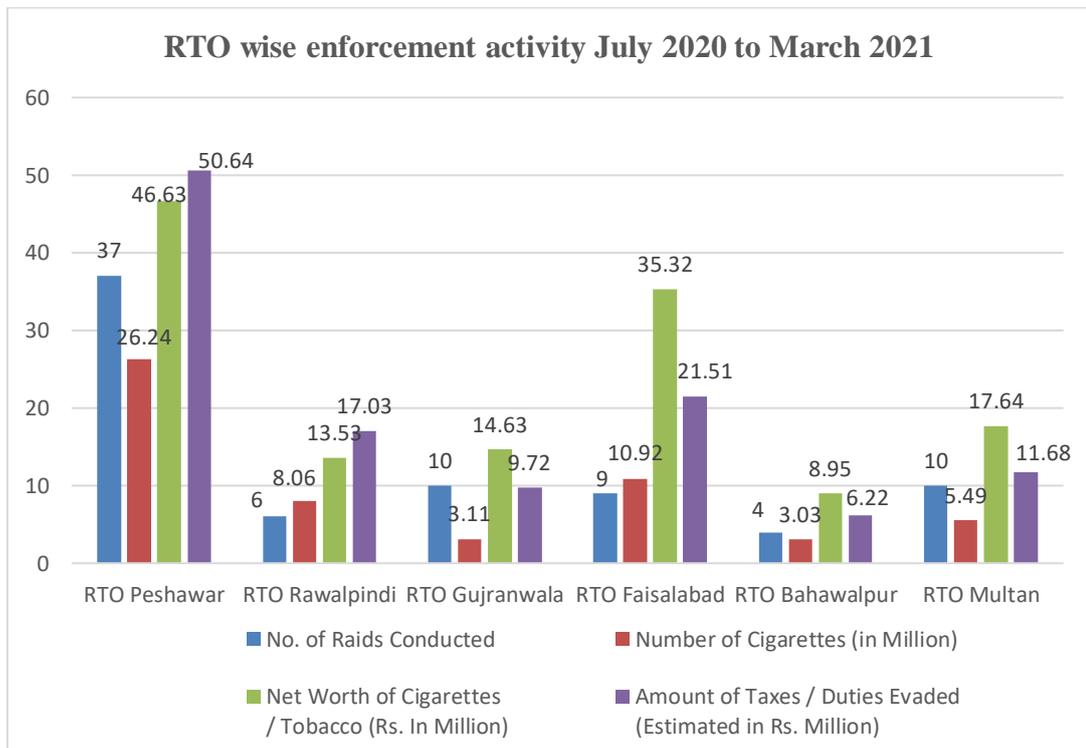
- b. proper warehouse buildings should be constructed in line with the international standards
- c. a separate wing under the supervision of the respective Chief Commissioner should be established for monitoring all the activities ancillary with the warehouses
- d. a system should be introduced to either affect the recovery or ensure disposal of the goods at the earliest

4.1.2. Lacklustre performance of Directorate of I&I and IREN squads

Chapter X–A of Sales Tax Rules, 2006 read with Rule 30 of the Federal Excise Rules, 2005, provide procedures regarding supply of taxable goods brought from tax-exempt areas into taxable areas. Rules provide that the person bringing or causing to bring taxable goods from the exempt area shall be required to be registered under the Sales Tax Act, 1990. All the provisions of taxation laws shall apply to the goods brought from Azad Jammu & Kashmir in the territory of the Government of Pakistan. The liability of payment of tax rests with the person bringing taxable goods from a tax-exempt area and supplying the same in the taxable area.

The stock of cigarettes examined by the Audit was either counterfeit or non-duty-paid. Formation-wise confiscation activity w.e.f. July 2020 to March 2021 (09 months) is presented in the following table and graph:

Formation	No. of Raids Conducted	Confiscated Cigarettes (sticks in million)	Value of Cigarettes (Rsin million)	Taxes / Duties Evaded (Rsin million)
RTO Peshawar	37	26.24	46.63	50.64
RTO Rawalpindi	6	8.06	13.53	17.03
RTO Gujranwala	10	3.11	14.63	9.72
RTO Faisalabad	9	10.92	35.32	21.51
RTO Bahawalpur	4	3.03	8.95	6.22
RTO Multan	10	5.49	17.64	11.68
Grand Total	76	56.85	136.70	116.80



The graphic presentation shows overall weak enforcement viz-a-viz illegal cigarettes trade prevalent in the country. The value of seized cigarettes stored at warehouses was only 0.78% in comparison with illegal trade at 18%. The raids conducted for seizure of non-duty paid cigarettes remained at the lowest ebb. When compared with expenditure and loss of revenue due to illegal cigarettes trade, it surfaced that a negligible amount of Rs 0.0015 was being spent on curbing illegal trade (expenditure Rs 354.867 million and revenue loss Rs 240.00 billion⁴). The same is the case with manpower and operational vehicles which add fuel to the fire of the issue. The facts reported above indicate that the enforcement function of IR in its present configuration and capacity was weak and unable to curb illegal trade.

The Audit recommends strengthening the enforcement function through incentives linked with performance appraisal, ample logistics, and proactive monitoring of the performance of IREN by higher management.

⁴Market Assessment of Illicit Cigarettes in Pakistan, IPSOS Pakistan, 2023

4.1.3. Failure to monitor the whole supply chain and non-implementation of Minimum Retail Price

Key regulation regime for tobacco industry in Pakistan follows the product from crop to consumer. It includes:

- Crops (Pakistan Tobacco Board Ordinance and MLO 487 to protect farmers)
- Green Leaf Threshing Units (GLT documentation and tax)
- Raw material (filter rods excise and cigarette paper import limitations)
- Manufacturing (excise duty structure and clearance)
- Distribution (compulsory tax invoice)
- Retail (health warning, pack retail price, and retailer license)
- Law enforcement agencies (fine of tax evasion, stock-machinery seizure, and stock destruction).

Moreover, as per SRO 1149(I)/2018 dated 18th September, 2018 each GLT is bound to file necessary data and information about its sale, purchase and customers to the competent authorities in the prescribed format.

The Audit observed that enforcement by FBR did not cover the whole supply chain and the seizure activities were limited to distributors/suppliers and traders only. In one case, filter rods manufactured by Khyber Tobacco Company (a registered producer) were used in the counterfeit production of cigarettes. In the instant case, legal proceedings were not initiated against KTC while the defaulter was fined with Rs 30,000 only. The raw materials for cigarette production are controlled and licensed under the current regulatory regime in Pakistan. However, the prevalent supply of counterfeit/non-duty paid cigarettes was indicative of loopholes in the current regulatory regime, particularly for raw materials. Tobacco is the main raw material in cigarettes which is processed by 09 GLT units located in Pakistan and 01 in AJK. The audit observed that implementation of SRO 1149(I)/2018 which requires submission of processing and sales data by GLTs to FBR was not enforced. On the other hand, it was also reported that the tobacco industry is complicit in black-marketing of its own

products or is failing to control its supply chain⁵. It was observed that an incident was reported at Mandra, Rawalpindi in 2020, whereby RTO Rawalpindi seized around 60 million non-duty paid cigarettes of Philip Morris Pakistan. In the instant case, the tax invoices of seized stock didn't match with serial numbers of cigarette cartons⁶. The case was pending in the High Court.

Furthermore, it was observed that FBR was unable to ensure the levy of Minimum Retail Price of Rs 120 per pack on cigarettes in the retail market. Only half of the cigarette packs sold in the market were duty paid. Traceability of the locally manufactured brands is a serious challenge, as 83% of the brands did not have tax stamps. These illegal cigarettes were openly sold in the market. Moreover, the retailers also advertised various rewards which is prohibited under the law. A survey of market regarding available illegal brands and their retail price is attached as **Annexure-B**.

In addition to non-duty paid cigarettes the incidence of smuggled cigarettes also increased in the market due to higher FED rates. Reportedly, the share of smuggled cigarettes in the total market share increased from 4.74% to 9.87% after the imposition of higher FED rates by the government⁷. These smuggled brands did not contain the statutory health warning and were available at cheap rates e.g. Milano (smuggled) was sold at Rs 150 per pack whereas Gold Leaf (locally manufactured) was available for Rs 500.

Audit recommends that the whole supply chain of tobacco products be closely monitored including the GLTs and retailers. Special implementation teams may be constituted for the purpose of on-site monitoring. Moreover, imported raw materials like filter rods and cigarette papers be strictly controlled to ensure traceability besides strict enforcement of Minimum Retail Price.

4.1.4 . Non-implementation of Track and Trace System

Pakistan is a signatory to the Illicit Trade Protocol which mandates the government to introduce Track and Trace System (TTS) to determine the origins of tobacco products. The protocol enshrines:

- a) Controlling the supply chain of tobacco products (Articles 6-13);

⁵Ross, H. et al, Tobacco Industry Strategies to Reduce Tax Liability, 2018. SALDRU working paper.

⁶<https://www.occrp.org/en/loosetobacco/without-a-trace/pakistans-big-tobacco-problem>, accessed on 5th October, 2023.

⁷Market Assessment of Illicit Cigarettes in Pakistan, Ipsos Pakistan, 2023.

- b) Addressing unlawful conduct and criminal offences through enforcement (Articles 14-19); and
- c) Promoting international cooperation through information sharing, mutual administrative and legal assistance, and extradition (Articles 20-31).

SRO 250(I)/2019 introduced the Track and Trace System for the tobacco sector. The system was implemented in July 2022 with the directive that no cigarette pack shall leave a factory premise without affixation of a tax stamp.

The Audit observed that FBR did not implement TTS in the tobacco sector. The confiscated cigarettes at the warehouses were without affixation of tax stamps/Unique Identification Markings (UIMs) on the packs. The TTS was implemented in only three (03) out of sixteen (16) registered tobacco producers. FBR failed to implement TTS in the rest of registered manufacturers. A stay order was granted by Peshawar High Court to local manufacturers, which was vacated in April 2023. In addition to this, the Audit could not derive assurance regarding any corrective/detection action initiated by FBR on the submitted data of TTS (for those manufacturers who had implemented the TTS).

RTO Bahawalpur informed during the DAC meeting held in January, 2024, that Track and Trace System had been installed at M/s Civic Tobacco Company.

Audit recommends that the track and trace system should be implemented in all registered units without further delay. In addition to this an efficient and transparent monitoring mechanism be developed for the review of data of track and trace system.

4.2. Financial Management

4.2.1 Non-disposal of confiscated cigarettes involving FED and sales tax - Rs116 million

Section 27 read with Section 19 (10) of the Federal Excise Act 2005 provides that in case of dutiable goods, seized on account of evasion of duty, the owner shall be given the option to pay penalties and fines in lieu of confiscation. In case the confiscated cigarettes are rendered unfit for human consumption or become otherwise unfit for sale, the Commissioner may allow the destruction of such cigarettes.

During the examination of the Inland Revenue warehouses, it was observed, that eight thousand nine hundred and nine (8,909) cartons of cigarettes were pending disposal for more than three years. The tax authorities neither realized the duty taxes involved nor disposed the goods according to laid down procedures. Moreover, no one approached the FBR authorities for handing back the stock. This was due to the fact that the cost of production of cigarette pack was very low (around Rs 10-12) while the tax liability on the same was tenfold. R TO-wise detail is given below:

RTO	Description of confiscated goods	Quantity of Cartons	Value of goods (Rs in Million)	Duty taxes involved (Rs in Million)	Remarks
Gujranwala	Local made DNP Cigarettes	803	22.93	16.220	Reports submitted for Adjudication
Sialkot	Local Made DNP Cigarettes	3,217	79.37	61.266	Reports submitted for Adjudication
Bahawalpur	Local Made DNP Cigarettes	45	1.11	0.854	Reports submitted for Adjudication
Peshawar	Local Made DNP Cigarettes	4102= 1530+2572*	-	28.81	Pending with various legal fora.
Lahore	Local Made DNP Cigarettes	722	72.02	9.267	Incident report 21/11/2017
Total		8,889	219.43	116.418	

*2,572 packs destroyed by RTO Peshawar after the conclusion of Audit activity

The above table shows that the highest quantity was present at RTO Sialkot and the least amount was confiscated in RTO Bahawalpur. The reported

duty and taxes in respect of RTO Lahore were comparatively lower than other RTOs.

The Audit observed that these items were perishable and should have been auctioned after observing the codal formalities. The oldest confiscation pertained to the year 2017. However, these had not been disposed of on the plea that these were counterfeit and injurious to health and that FBR had banned their auction in compliance with instructions of the Ministry of National Health and Services Regulation. The audit is of the opinion that even if these goods were not disposed of by auction their destruction should have been carried out as per the laid down procedures. This shows inaction and inefficiency of the management in the timely disposal of confiscated goods.

RTO Sialkot informed in the DAC meeting held in January, 2024, that 3,339 cartons had been destroyed on 04-07-2023.

Audit recommends inquiry into the lethargy in disposal of cigarette cartons and framing rules governing disposal of counterfeit goods.

4.2.2. Non-recovery of adjudged government revenue – Rs 54 million

According to Section 48 of the Sales Tax Act, 1990 and Section 14 of the Federal Excise Act, 2005, an officer of Inland Revenue may recover the tax assessed from a taxpayer. Section 138 of the Income Tax Ordinance, 2001 provides for recovery of the due tax, accordingly, the Commissioner may serve upon the taxpayer a notice in the prescribed form (Orders-in-Original) and recover the arrears through attachment and sale of any movable or immovable property of the taxpayer. This may lead to the arrest of the taxpayer and his detention in prison for a period not exceeding six months.

Audit observed that Orders-in-Original have been made involving tax demand of Rs 53.64 million. However, no recovery was made despite lapse of a considerable period. Detail is given as follow: -

Station	Period	No. of cartons	Duty/taxes involved (Rs in million)	Manufacturer / Brand
Bahawalnagar	17/12/2019	80	19.14	Gold Street, Classic & Hero

Chishtian	1/12/2021	201	22.02	Gold Street, Classic, Hero & Kisan
Haroonabad	17/11/2021	80	11.47	-
Hasilpur	30/11/2021	45	1.01	M/s Khyber Tobacco Co.
Total		406	53.64	

As evident from the table above the oldest seizure activity pertained to 2019 whereas the assessment order was passed in 2022 after a lapse of almost 03 years. No further legal action was initiated by the authorities.

RTO Sialkot and Bahawalpur informed during the DAC meeting held in January, 2024, that entire amount was under recovery. The DAC, directed the RTOs to expedite the recovery proceedings and submit progress to audit and FBR by 31.01.2024. The department did not intimate recovery position till the finalization of the report.

The Audit recommends proactive action to materialize and recover government revenue besides fixing responsibility.

4.3. Overall Assessment

4.3.1. Potential tax evasion in tobacco sector – Rs 240 Billion

According to a report of IPSOS (May 2023), the illicit cigarette trade is estimated to be at 48%.The illicit cigarettes trade is comprised of 90% locally manufactured and 10% smuggled ones. Tax evasion in tobacco sector is around Rs 240 Billion per year as only two multinational tobacco companies pay 99% of total taxes and local manufacturers pay only 1%. The tax evaded cigarettes are sold at a significantly lower price than the minimum legal price of Rs 123.440 which is inclusive of the minimum tax⁸.

The huge incidence of illicit trade of cigarettes depicts a gap in FBR's performance in enforcement and border control. Customs department is primarily responsible for curbing smuggling at the borders whereas Directorates of I&I and IREN squads conduct operations locally within their territorial

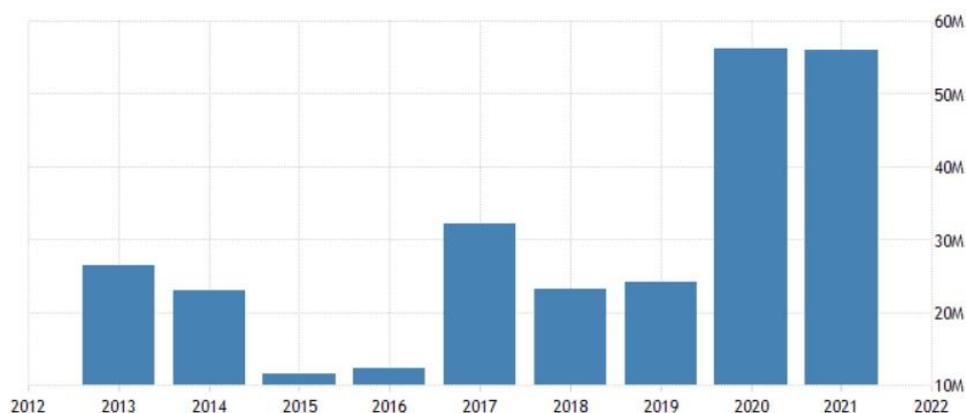
⁸Market Assessment of Illicit Cigarette Brands in Pakistan, IPSOS Pakistan, May 2023, pp 04.

jurisdictions. There was no intelligence sharing mechanism with other formations or departments to operate against manufacturing units located outside the jurisdiction of respective RTOs. In some seizure cases, the defaulters were fined a paltry sum of Rs 10,000 to 15,000 for being retailers/traders and first-time offenders. In some cases, the confiscated stock was handed over to FBR by local police without any details about the offenders. This depicts a lack of coordination between government departments for curbing illicit trade. Most of the smuggling occurred through the porous Afghan-Iran border while most non-duty-paid cigarettes originated from non-tariff areas (former FATA/PATA and Bhimber/AJK). It is also pertinent to mention that anti-smuggling powers are vested in Pakistan Customs under the Prevention of Smuggling Act, 1977. These powers are delegated by Customs authorities to other departments every year. The Audit is of the view that delegation of these powers leads to a diffusion of responsibility and shifts the onus to multiple entities whereby accountability is difficult to establish.

The Audit observed that in addition to lax border control the local enforcement was also disorganized and uncoordinated. Enforcement was obstructed because of limitations of territorial jurisdiction. In this regard, coordination among the Directorates of I&I, IREN squads and relevant intelligence and law enforcement agencies was lacking. A market survey showed that 61% brands surveyed in the market were sold below the minimum retail price. Smuggled cigarettes are easier to spot since they do not contain the mandatory graphic health warning in Urdu as required by Ministry of National Health & Services Regulations and Coordination (MNHSRC). Reportedly, smuggling had been the main beneficiary of the FED hike as its share doubled since February 2023⁹. Moreover, according to an industry representative, no consignment of imported cigarettes in Pakistan had been made legally since 2014 after the imposition of health warning requirements which made the import impractical/uneconomical. Federal Government increased the excise duty on cigarettes successively over the years. Pakistan also witnessed successive increase in its tobacco exports as depicted by the following graph:

⁹ Market assessment of illicit Cigarette Brands in Pakistan, Ipsos Pakistan, May 2023, pp 05.

Pakistan Tobacco exports 2012-2021



(Source: COMTRADE Trading economics)

The principal destination of the Pakistani origin tobacco was UAE in FY 2021-22 which constituted 23% of the total exports. The exported tobacco is reportedly utilized for cigarette manufacturing in UAE and smuggled back to Pakistan via Iran and Afghanistan.

Illicit trade in tobacco products undermines tobacco control indirectly when tobacco companies use the presence of illegal tobacco products on the market to demand less stringent tobacco control policies and tax increases. They argue that higher taxes and prices would motivate smokers to buy illegal products rather than quitting and also effect tax revenue adversely. However, numerous empirical studies dismiss this argument and point toward increased revenue as well as decline in smoking¹⁰. For example, the market share of illicit cigarettes in the United Kingdom (UK) declined from 30.9% in 2000 to 21% in 2010 (National Audit Office UK, 2013) while cigarette taxes and tobacco tax revenue continued to rise, and the prevalence of cigarette use declined¹¹. The Audit is of the view that the increase in incidence of smuggling and NDP

¹⁰International Agency for Research on Cancer (IARC), Effectiveness of Tax and Price Policies for Tobacco Control, Volume 14, IARC Handbooks, 2011.

¹¹ Institute of Health Research and Policy (IHRP), Illicit trade in tobacco products need not hinder tobacco tax policy reforms, 2019

cigarettes is because of weaknesses in local enforcement and border control rather than the FED hike.

The Audit recommends that enforcement be strengthened through integrated intelligence networks including all the stakeholders i.e. FBR, local law enforcement agencies, provincial Excise departments, FIA, IB, and industry representatives. Smuggling of goods from non-tariff to tariff areas especially from AJK be checked through strategically located check-posts. The production data of Green Leaf Threshers (GLTs) should be monitored. Likewise, local enforcement through raids on identified vendor hotspots (**Annex-A**) needs to be planned and executed with the help of local law enforcement agencies. Incentives for enforcement activity like cash rewards, designated uniforms and logistics may be provided to IREN officers/officials for improving performance.

5. CONCLUSION

The objectives of confiscation of goods were not achieved for either revenue or enforcement. Standard operating procedures and timelines for the disposal of confiscated goods particularly counterfeit goods were not uniform. The internal audit should carry out regular inspection and monitoring of these warehouses. Increase in incidence of smuggled cigarettes points towards ineffective border control and lack of local enforcement. Local enforcement activities were restricted to distributors/suppliers while no action was initiated against the manufacturing units and retail outlets. Non-disposal of confiscated goods, lack of comprehensive approach towards enforcement, weak prosecution, non-monitoring of GLTs, and non-implementation of TTS reflect poorly on the performance of the department. Administrative action after confiscation was limited to the issuance of assessment orders and dumping of the stock in warehouses. Legal proceedings were initiated but produced no tangible result. Resultantly a unified line of action was found to be missing which could halt the supply of counterfeit/non-duty-paid and smuggled cigarettes.

ACKNOWLEDGEMENT

We wish to express our appreciation to the management and staff of the field formations of the Federal Board of Revenue for the assistance and cooperation extended to the auditors during this assignment.

ANNEX-A

Hotspots of illicit trade

1. Karkhano Bazaar, Peshawar
2. Nankari Bazaar, Rawalpindi
3. Joria Bazaar, Karachi
4. Kaghazi Bazaar, Karachi
5. Main Bazaar, Quetta
6. Pan Mandi, Shah Alam Market, Lahore
7. Wesh Market, Chaman Border
8. Bara Bazaar, Sargodha
9. Samma Satta Town, Bahawalpur
10. Choori Saraye Bazaar, Multan
11. Kup

ANNEX-B**Locally Manufactured DNP Brands and Retail Price**

S. No	Brand Name	Manufacturer	Market Selling Price
1	Allwin Classic KSF	Souvenir Tobacco Company	60
2	Armee	Universal Tobacco Company	50
3	Aroma	International Cigarette Industries	70
4	Badshah	Shaheen Tobacco	80
5	Bridge	Walton Tobacco Company	60
6	Café	Universal Tobacco Company	100
7	Canton	SCIL Pakistan	60
8	Champion International	Royal Tobacco Company	50
9	Champion Lights	Royal Tobacco Company	70
10	Chance	Civil Tobacco Company	100
11	Channel 5	SCIL Pakistan	70
12	Champion	Royal Tobacco Company	70
13	CITI Gold	Frontier Leaf Tobacco	60
14	Classic	Wattan Tobacco Company	80
15	Crown	Khyber Tobacco Company	80
16	Dubai Lights	Asia Tobacco	80
17	Express	Walton Tobacco Company	70
18	Gold Cup	Walton Tobacco Company	80
19	Gold Mark	Walton Tobacco Company	100
20	Gold Street	Walton Tobacco Company	100
21	Gold Street Classic	Khyber Tobacco Company	100
22	Gold Street International	Walton Tobacco Company	100
23	Grace	Wattan Tobacco Company	50
24	Hera	Paramount Tobacco	80
25	Hero	Walton Tobacco Company	100
26	Hi-Way	Paramount Tobacco	80
27	Honda	National Tobacco	100
28	Jump	Sultan Tobacco	50
29	Kick	Indus Tobacco	80

30	Kisan	Civil Tobacco Company	100
31	Legate White	L3	70
32	Lord	Souvenir Tobacco Company	70
33	Lord One KSF	Souvenir Tobacco Company	70
34	Lord One Light KSF	Souvenir Tobacco Company	100
35	Melburn	Souvenir Tobacco Company	100
36	Melburn Gold	Souvenir Tobacco Company	100
37	Melburn KSF	Souvenir Tobacco Company	70
38	Member	New Kashmir Tobacco	70
39	Minar	Royal Tobacco Company	50
40	More One	Universal Tobacco Company	70
41	Olympic	Civil Tobacco Company	100
42	Party	International Cigarette Industries	70
43	Pilot	International Tobacco Company	50
44	Power	New Kashmir Tobacco	50
45	Press	Civil Tobacco Company	70
46	R6	Royal Tobacco Company	90
47	Ranger	Universal Tobacco Company	60
48	SMS	Royal Tobacco Company	60
49	SMS International	Royal Tobacco Company	70
50	Wonder	International Tobacco Company	50
51	Wonder Classic	International Tobacco Company	50

Source: Market Intelligence & IPSOS – May 2023