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FEDERAL TAX OMBUDSMAN SECRETARIAT

Islamabad

Complaint No.88/Isd/Suo Moto(1)1100/2012

Dated: 17.08.2012

Mr. Waheed Shahzad Butt
Advocate High Court
Lahore

... Petitioner

Versus

The Secretary
Revenue Division
Islamabad

... Respondent

Dealing Officer	:	Hafiz Ahsan Ahmad Khokhar, Advisor
Petitioners	:	Mr. Waheed Shahzad Butt, Advocate Mr. Farhan Shahzad, General Secretary, Lahore Tax Bar Association
Departmental Representatives	:	Mr. Basit Salim, Secretary (IR), FBR Mr. Zaheer Qureshi, Second Secretary (IR), FBR

FINDINGS/RECOMMENDATIONS

This is a public interest complaint of systemic maladministration involving discriminatory, unreasonable and unfair treatment to certain 'salaried individuals' falling under First Schedule, Part I, Division I [clause(1A)] of Income Tax Ordinance 2001 (the Ordinance), as amended through Finance Act 2012.

2. The complaint was sent for comments on 27.07.2012 to Secretary, Revenue Division, in terms of Section 10(4) of the FTO Ordinance 2000. In response, the FBR submitted comments, vide their No.4 (60)ITP/2012 dated 07.08.2012.

3. The Complainant contends that there is a serious anomaly in the tax rate slabs 4, 5 and 6 for the salaried individuals:

* Date of registration in FTO Sectt.

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Slab	Taxable income in rupees	Rate of tax
1	0 to Rs400,000/-	0%
2	Rs400,000/- to Rs750,000/-	5% of the amount of exceeding Rs400,000/-
3	Rs750,000/- to Rs1,500,000/-	Rs17,500/- + 10% of the amount of exceeding Rs750,000/-
4	Rs1,500,000/- to Rs2,000,000/-	Rs95,000/- + 15% of the amount of exceeding Rs1,500,000/-
5	Rs2,000,000/- to Rs2,500,000/-	Rs175,000/- + 17.5% of the amount of exceeding Rs2,000,000/-
6	Rs2,500,000/- and above	Rs420,000/- + 20% of the amount of exceeding Rs2,500,000/-

A perusal of tax liability for slabs 4, 5 and 6 shows that FIXED TAX FACTOR (FTF), which is Rs95,000, Rs175,000 and Rs420,000 respectively, has been incorrectly calculated. Whereas Final Tax Component (Fixed + Variable) of slab 2, for instance, has been adopted as minimum tax in slab 3, the position is different for slabs 4, 5 and 6. In slab 4, FTF is Rs95,000 as against Rs92,500 worked out on the basis of the formula applied to slabs 2 and 3. This is obviously unjustified and discriminatory. Similarly, FTF is Rs175,000 as against Rs167,500 for slab 5 and Rs420,000 as against Rs255,000 for slab 6.

4. Lahore Tax Bar Association (LTBA) has also taken up the same issue in writing, contending that tax rate slabs for salaried individuals needed correction at the earliest. According to LTBA, FBR had adopted wrong formula for the taxpayers falling under slabs 4, 5 and 6 of the revised tax slabs. LTBA has prayed that the Department should issue a notification for rectification of obvious anomalies so that the taxpayers are able to deposit accurate amount of income tax.

5. The DR admitted that the computation formula prescribed in the Finance Bill 2012 did not have the anomalies that have been pointed out by the Petitioner as well as LTBA. However, the computation it was changed through the Finance Act 2012. The DR contended that the collective wisdom of the Parliament approved the scheme of taxation in the best national interest. Not only was maximum relief provided to low

salary individuals but the relief was progressively decreased with the increase in salary. He further contended that in highest tax rate slab only basic exemption of Rs400,000/- was provided and the benefit of lower rates of intermediate slabs was not passed on to the taxpayers. This is apparent from the fact that for this slab, the applicable FTF is Rs420,000, instead of Rs255,000/- which would have been the case had the benefit of lower rate of previous slabs been provided to taxpayers in this slab. In slab 5, the FTF is Rs175,000, instead of Rs167,500, and in slab 4, it is Rs95,000, instead of Rs92,500. For slabs 1, 2 and 3, however, the benefit of previous slab's FTF has been correctly retained. He finally submitted that instead of applying higher tax rates on gross salary, tax rate had been made progressive by changing FTF for different slabs through the Finance Act 2012.

6. The Petitioners contend that the formula adopted for different tax slabs introduced through the Finance Act 2012 was arbitrary, unjust and discriminatory. Rather than unfairly changing FTF for slabs 4, 5 and 6, the rate of 'variable component' for each slab ought to have been appropriately enhanced. On the other hand, the Department contends that instead of applying higher tax rates on 'variable component' of salary, the same purpose was achieved through progressive FTFs.

7. The following Table further reveals the anomalous situation created by the computation scheme introduced under the Finance Act 2012:

Case No.	Annual Salary	Tax Under New Rates	Take Home	Comments
1A	1,499,999	92,500	1,407,499	Increase in salary by just Rs2 increases the payable tax by Rs2,500/- and decreases the net take-home salary by Rs2,498
1B	1,500,001	95,000	1,405,001	
2A	1,999,999	170,000	1,829,999	Increase in salary by just Rs2 increases the payable tax by Rs5,000/- and decreases the net take-home salary by Rs4,998.
2B	2,000,001	175,000	1,825,001	
3A	2,499,999	262,500	2,237,499	Increase in salary by just Rs2 increases the payable tax by Rs157,500/- and decreases the net take-home salary by Rs157,498.
3B	2,500,001	420,000	2,080,001	

Clearly, an increase in annual salary of just 2 Rupees (case 1A & 1B) leads to an increase in tax liability amounting to Rs2,500 whereas the same increase of 2 Rupees in annual salary (case 2A & 2B) leads to an increase in tax liability of Rs5,000. The addition of same amount of 2 Rupees in annual salary (case 3A & 3B) results in an increase in tax liability of Rs157,500. This is perverse, unreasonable, unjust, oppressive and discriminatory. It also smacks of incompetence, inefficiency and ineptitude on the part of Revenue Division.

8. As to the Departmental contention that progressive tax rates have been introduced through the Finance Act 2012, in reality the outcome is otherwise. This is evident from the following example:

Total Annual Salary Rs3,000,000	Finance Act 2012	
	Tax Liability	Resulting Tax Rate
First Rs400,000	-	0%
Next Rs350,000	Rs17,500	5.00%
Next Rs750,000	Rs77,500	10.33%
Next Rs500,000	Rs80,000	16.00%
Next Rs500,000	Rs245,000	49.00%
Next Rs500,000	Rs100,000	20.00%

9. It is evident that when a taxpayer's annual salary increases from Rs2,000,000 to Rs2,500,000, the additional amount of Rs500,000 is taxed @ 49%. However, if the annual salary increases from Rs2,500,000 to Rs3,000,000, the same additional amount of Rs500,000 is taxed @ 20%.

Findings:

10. Tax computation mechanism that militates against the principles of horizontal and vertical equity clearly violates Articles 4 and 25 of the Constitution. Being arbitrary, unreasonable, unjust and discriminatory, such a treatment is tantamount to maladministration as defined in Section 2(3) of the FTO Ordinance 2000. The argument that the newly introduced slabs are based on the collective wisdom of the Parliament does not hold water, as the changes in what was proposed in the Finance Bill 2012 to

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what emerged in the Finance Act 2012 do not, prima facie, appear to have been effected after debate or discussion in the Parliament. It seems that the Parliament has not been properly assisted by the FBR in this matter.

Recommendations:

11. FBR to-
 - (i) take urgent steps to address the glaring anomalies in income tax slabs (4, 5 and 6) introduced under clause (1A) of First Schedule, Part I, Division I of Income Tax Ordinance 2001; and
 - (ii) report compliance within 30 days.

(Dr. Muhammad Shoaib Suddle)
Federal Tax Ombudsman

Dated: 12-10-2012