

# TAX UPDATE

*An Update on*

## *Taxability of Salary*

*Under the Income Tax Ordinance, 2001 & Income Tax Rules, 2002  
(Applicable w.e.f. July 1, 2009)*

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## What this document aims at?

The purpose of this document is to briefly summarize the concept of computation of income from salary and computation of tax thereon.

The information and elaborations as contained herein are general in nature and based on our interpretation of the applicable statute. As such nothing contained herein should be taken as legal advice in a given case.

## Summary of changes vide the Finance Act, 2009

### **Relief Measures**

**Basic Exemption** Limit for salaried taxpayers increased to Rs. 200,000 from existing Rs. 180,000.

Basic exemption limit raised to Rs. 260,000 for salaried **Women Taxpayers** from current threshold of Rs. 240,000.

Increase in base parameters from 40% to 50% of taxable income as well as increasing the monetary threshold from Rs.500,000 to Rs. 750,000 for allowing **Tax Credit for Profit on Debt** for construction or acquisition of a house.

Increase in income threshold for **Senior Citizens** from existing Rs. 500,000 to Rs. 750,000 for computing reduction in tax liability.

### **Revenue Measures**

A new tax under the head **Internally Displaced Persons Tax (IDPT)** has been imposed on corporate employees with taxable income of Rs. 1 Million or more at 5% of tax liability for the tax year 2009.

IDPT for tax year 2010 will be charged at 30% on bonus where taxable income (excluding bonus) is Rs. 1 Million or more.

### **Other Measures**

Salaried taxpayers with income of Rs. 500,000 or more are required to **file returns electronically** along with the proof of tax deduction or payment and the **wealth statement**.

## Exempt allowances & benefits

Description	Condition/ Limit
<b>Medical benefit or reimbursement*</b>	Medical facility or hospital charges* are fully exempt, if provided in accordance with the terms of employment. * Exemption is available only when NTN of the hospital or clinic is disclosed and the employer certifies and attests the bills.
<b>Medical Allowance</b> (without medical facility)	Exempt up to 10% of basic salary.
<b>Special allowance or benefit</b> (other than entertainment or conveyance allowance)	If granted to meet expenses wholly and necessarily incurred in the performance of duties is fully exempt.
<b>Employer's contribution to provident fund</b>	Exempt up to lower of Rs.100,000 and 10% of salary, such that the amount does not exceed employee's contributions.
<b>Gratuity/ superannuation/ Commutation of Pension</b> (received in Pakistan by residents)	<b>On retirement/ death</b>
	<b>Receipts from</b>
	<b>Treatment</b>
	<b>Approved Funds</b> Fully Exempt
	<b>Approved Schemes</b> Exempt up to Rs.200,000
	<b>Other cases</b>
	Exempt up to lower of 50% of the amount or Rs. 75,000. Residual amount to be taxed at the current rate of tax.
<b>Pension</b>	Fully exempt, where the person does not continue to work for the same employer or an associate of the employer. In case of pensions from more than one source, the pension representing the highest amount would be exempt.

## Taxable allowances & benefits

All allowances and benefits other than the above are fully taxable. Few of the prominent and common items in this list include:

Description	Remarks
<b>Utilities</b> (water, gas, electricity allowance)	Fully Taxable
<b>House rent allowance</b>	Fully Taxable
<b>Accommodation</b> (whether furnished or not)	45% of basic salary to be included in taxable salary
<b>Leave Fare Assistance</b>	Fully Taxable
<b>Salary of domestic servant</b> (house-keeper, gardener, etc.)	Fully Taxable
<b>Capital receipt on termination of employment</b>	Fully chargeable to tax
<b>Tax paid by the employer</b>	Salary is to be grossed-up by the amount of tax paid by the employer on behalf of the employee.
<b>Interest-free loans to employees or loans at concessional rates</b>	Taxable at the difference between the <b>benchmark rate</b> and the rate charged. The rate was fixed at 5% for the tax year 2003 with 1% annual increment until notification by the Federal Government. Thus the <b>rate for tax year 2010 is 12%</b> .
<b>Conveyance allowance</b> (all types and cases)	Fully taxable
<b>Motor vehicle</b> (owned and maintained by employer)	<b>Partly for private use</b> Taxable at 5% of cost/ FMV at the time of commencement of lease.  <b>Wholly for private use</b> Taxable at 10% of cost/ FMV at the time of commencement of lease.

### Taxable allowances & benefits (Contd.)

Description	Remarks
Waiver of loan by the employer	Fully taxable
Discharge of debt by employer	Fully taxable
Transfer of assets or property	To be included in income of the employee at fair market value less value of consideration paid.
Employee share scheme	<p><b>Value of right/ option</b> under an Employee Share Scheme is not chargeable to tax until:</p> <p>(a) the right/ option is disposed; or (b) shares are acquired.</p> <p><b>Amount taxable against disposal of right/ option</b> is the difference between:</p> <p>(a) consideration for right/ option; and (b) cost in respect of said right/ option.</p> <p><b>Amount taxable at acquisition of shares</b> is difference between:</p> <p>(a) fair value of shares; and (b) sum paid against right/ option and the shares.</p> <p>If shares acquired are under restriction as to transfer, the amount is includable only at the earlier of:</p> <p>(a) acquisition of transfer rights; or (b) at the time of actual disposal of shares.</p>

### Allowable deductions

Description	Eligibility Criteria	Limit
Donations	Paid to institutions, foundations, societies, boards, trusts and funds as per Clause (61) Part-I of 2nd Schedule to the Income Tax Ordinance	Up to 30% of taxable income
Zakat	Paid or deducted under the Zakat and Ushr Ordinance	100% (i.e. the full amount of zakat)

### Tax credits

Certain tax credits are also available against specified items as per the following formulae:

$$\text{Applicable Amount}^* \times \frac{\text{Tax before allowance of tax credit(s)}}{\text{Taxable income for the tax year}}$$

Specified Items for Tax Credit			
* Applicable Amount (lower)	Charitable donations - Note1	Investment in listed shares - Note2	Contribution to approved pension fund
	Profit on debt on loans for purchase or construction of house - Note4		
	Amount of donation or fair value of property donated	Cost of acquisition 10% of taxable income	Actual annual contribution 20% of taxable income - Note3
	30% of taxable income	Rs. 300,000/-	Rs. 500,000/- Rs. 750,000/-

**Note1:** Includes donations not covered under 2<sup>nd</sup> Schedule if made to:

- local education boards/ universities established under Federal/ Provincial law,
- educational institution/ hospital/ relief fund established/ run in Pakistan by Federal/ Provincial Govt. or local authority, or
- approved non-profit organizations.

## Tax credits (Contd.)

**Note2:** Entitlement is restricted to original allotments and acquisition of shares from the Privatization Commission of Pakistan.

**Note3:** Additional contribution allowed to persons joining a fund up to Jan 26, 2015 (first 10yrs from the date of related notification) if the age at joining is 41yrs or above @ 2% for each year exceeding the age of 40 years such that the applicable amount does not exceed 50% of last year's taxable income.

**Note4:** Profit on debt means profit/ share in rent and appreciation in value of house paid to banks, financial institutions, government, local authority, statutory body or listed company. This implies that loan from employer is also covered if it is a listed company or statutory body.

## Annual return & wealth statement

Case	Filing Requirement
Were salary income is <b>less than Rs.500,000</b> and there is no other source of income	No need for any tax filing, since the Annual Statement filed by the employer constitutes the tax return
Were salary income is <b>less than Rs.500,000</b> and the taxpayer also has income/ loss from any other source	The taxpayer needs to file annual tax return manually and a wealth statement (only in case the total income is Rs. 1Million or more)
Were salary income is <b>Rs.500,000 or more</b> (irrespective of the fact whether or not there are some other income sources)	The taxpayer needs to <b>electronically file</b> the annual tax return along with a wealth statement

## Exemption Limits

Women taxpayers	Rs. 260,000
Others	Rs. 200,000

## Tax rates

Taxable Income (Rs.)		Rate of Tax (%)	Taxable Income (Rs.)		Rate of Tax (%)
From	Up to		From	Up to	
200,001	250,000	0.50%	1,200,001	1,450,000	11.00%
250,001	350,000	0.75%	1,450,001	1,700,000	12.50%
350,001	400,000	1.50%	1,700,001	1,950,000	14.00%
400,001	450,000	2.50%	1,950,001	2,250,000	15.00%
450,001	550,000	3.50%	2,250,001	2,850,000	16.00%
550,001	650,000	4.50%	2,850,001	3,550,000	17.50%
650,001	750,000	6.00%	3,550,001	4,550,000	18.50%
750,001	900,000	7.50%	4,550,001	8,650,000	19.00%
900,001	1,050,000	9.00%			
1,050,001	1,200,000	10.00%			

The above **rates are to be applied directly to the taxable salary** without deducting the basic exemption amount.

## Treatment of marginal limits Where Income Marginally Exceeds Maximum Limit in a Slab

Taxable Income (Rs.)	Upto 0.55M	Upto 1.05M	Upto 2.25M	Upto 4.55M	Above 4.55M
On Maximum Amount of the Previous Slab	As per Respective Slab Rates				
On Marginal Amount	20%	30%	40%	50%	60%

## Reduction in tax liability

Applicability	Rate of Reduction	Eligibility criteria
Senior citizens	50%	Age to be 60 yrs or more on the first day of tax year and income does not exceed Rs.750,000/-
Full time teachers & researchers	75%	Employed in a recognized non profit education or research institution (including government training & research institutions)

## Internally Displaced Persons Tax (IDPT)

Tax Year	Criteria	Chargeable on	Rate (%)
2009	Income is Rs. 1M or more	Tax payable	5%
2010	Ex-bonus Income Rs. 1M or more	Bonus received/ receivable	30%

### Worked examples – Computation for the Tax Year 2010

Case	Salary (including taxable allowances & perquisites and excluding Bonus)	Bonus	Gross Salary	Income Tax Payable			IDP Tax (30% on Bonus)	Total Tax Liability	
				Without Considering Marginal Limit (A)	Considering Marginal Limit (B)	Lower of (A) and (B)			
				Rate	Amount (Rs.)	Amount (Rs.)			
1	182,273	18,227	200,500	0.50%	1,003	100	100	-	100
2	204,545	20,455	225,000	0.50%	1,125	5,000	1,125	-	1,125
3	218,182	21,818	240,000	0.50%	1,200	8,000	1,200	-	1,200
4	245,455	24,545	270,000	0.75%	2,025	5,250	2,025	-	2,025
5	272,727	27,273	300,000	0.75%	2,250	11,250	2,250	-	2,250
6	300,000	30,000	330,000	0.75%	2,475	17,250	2,475	-	2,475
7	376,364	37,636	414,000	2.50%	10,350	8,800	8,800	-	8,800
8	384,415	38,442	422,857	2.50%	10,571	10,571	10,571	-	10,571
9	396,818	39,682	436,500	2.50%	10,913	13,300	10,913	-	10,913
10	510,000	51,000	561,000	4.50%	25,245	22,550	22,550	-	22,550
11	519,608	51,961	571,569	4.50%	25,721	25,721	25,721	-	25,721
12	555,455	55,545	611,000	4.50%	27,495	37,550	27,495	-	27,495
13	847,273	84,727	932,000	9.00%	83,880	77,100	77,100	-	77,100
14	876,624	87,662	964,286	9.00%	86,786	86,786	86,786	-	86,786
15	915,455	91,545	1,007,000	9.00%	90,630	99,600	90,630	-	90,630
16	1,354,091	135,409	1,489,500	11.00%	148,950	181,636	148,950	40,623	189,573
17	1,390,083	139,008	1,529,091	11.00%	152,909	196,033	152,909	41,702	194,611
18	1,467,727	146,773	1,614,500	12.50%	183,466	166,591	166,591	44,032	210,623
19	2,075,455	207,545	2,283,000	15.00%	311,318	335,728	311,318	62,264	373,582
20	2,105,615	210,561	2,316,176	15.00%	315,842	350,808	315,842	63,168	379,010
21	2,348,182	234,818	2,583,000	16.00%	375,709	386,591	375,709	70,445	446,154
22	7,961,818	796,182	8,758,000	19.00%	1,512,745	2,888,841	1,512,745	238,855	1,751,600
23	8,060,227	806,023	8,866,250	19.00%	1,531,443	2,947,886	1,531,443	241,807	1,773,250
24	10,909,091	1,090,909	12,000,000	20.00%	2,181,818	2,998,955	2,181,818	327,273	2,509,091

### Worked examples – Computation for the Tax Year 2009

Case	Salary (including taxable allowances & perquisites and excluding Bonus)	Bonus	Gross Salary	Income Tax Payable			IDP Tax (5% on Income Tax Payable)	Total Tax Liability
				Without Considering Marginal Limit (A)	Considering Marginal Limit (B)	Lower of (A) and (B)		
				Rate	Amount (Rs.)	Amount (Rs.)		
1	840,000	84,000	924,000	9.00%	83,160	74,700	-	74,700
2	909,091	90,909	1,000,000	9.00%	90,000	97,500	4,500	94,500
3	1,090,909	109,091	1,200,000	10.00%	120,000	154,500	6,000	126,000
4	1,309,091	130,909	1,440,000	11.00%	158,400	216,000	7,920	166,320
5	1,570,909	157,091	1,728,000	14.00%	241,920	223,700	11,185	234,885
6	1,885,091	188,509	2,073,600	15.00%	311,040	334,800	15,552	326,592
7	2,261,818	226,182	2,488,000	16.00%	398,080	456,500	19,904	417,984
8	2,714,182	271,418	2,985,600	17.50%	522,480	523,800	26,124	548,604
9	3,256,364	325,636	3,582,000	18.50%	662,670	637,250	31,863	669,113
10	3,863,636	386,364	4,250,000	18.50%	786,250	971,250	39,313	825,563

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