

TAXATION OF INCOME FROM SALARY **TAX YEAR 2012. (1st July '11 - 30th June '12)**

The Computation of Tax of a Salaried Person has been defined under section 12, 13 and 14 of the Income Tax Ordinance, 2001 read with rules 2 to 7 of the Income Tax Rules, 2002.

Every employer paying salary to an employee shall, at the time of payment deduct tax from the amount paid at the employee's **average rate of tax** computed at the rates specified in **Division I** of the *First Schedule* on **the estimated income** of the employee chargeable under the head "salary" for the tax year in which the payment is made after making adjustment of tax withheld from employee under other heads and allow tax credit and admissible deduction **U/S 60, 61, 62, 63 and 64** during the tax year after obtaining documentary evidence as may be necessary.

1. BASICS

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|--------------------------------------------|--------------------------------|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Definitions: | R-06 | "Employee" includes a director of a company. "Salary Tax Payer" is a person having salary income in excess of 50% of his/her Taxable Income. |
| Application: | R-07 | These rules shall be applicable for salary received after 30th June, 2007 [Tax Year 2008 and onwards) |
| Basic Exemption Limit. | 1st Schedule Part I, Div I | Rs.350,000/- |
| Persons required to file the Return | u/s. 114(1)(1) | Where Salary is the only Income and Employer has deducted tax on Taxable Salary Income Employees are not required to file Return. Where Salary Income exceeds Rs. 500,000/- employees are required to file Return of Income together with the Certificate of Collection or Deduction of Income tax from employer through e-filing. (Rule 42.) Where an income exceeds Rs. 1,000,000/- person is required to file Return of Income together with the Certificate of Collection or Deduction of Income Tax from employer through e-filing together with Wealth Statement |
| Due Date for filing of the Return. | U/S 116(2) | Salaried Taxpayers..... September 30th of every year. |
| Rate applicable to Salaried Person. | 1st Schedule Part I, Div I/C.1 | [Vide Finance Act, 2011 effective Tax year 2012] As per sheet attached. |

1. SALARY INCOME. –

[The basis of levy of income tax on “**GROSS SALARY**” instead of “**NET SALARY**” effective tax year 2008 has been introduced. Now all Allowances and Perquisites – except those Exempted under Second Schedule – are to be clubbed to salary for taxation purposes.]

i. **RULE – 3 of INCOME TAX ORDINANCE 2002,**

VALUATION OF PERQUISITES, ALLOWANCES & BENEFITS:

The value of all perquisites, allowances and benefits provided by employer to the employee shall be included in the income chargeable to tax in accordance with **rule 4 to 7.**

ii. **RULE – 4 of INCOME TAX ORDINANCE 2002,**

VALUATION OF ACCOMMODATION:

The value of accommodation provided by an employer to employee shall be taken equal to the amount that would have been paid by the employer. In case such accommodation was not provided

Provided that the value taken for this purpose shall, in any case, not less than forty five percent of the minimum of the time scale of the basic salary where there is no time scale.

Provided further that where House Rent Allowance is admissible @ thirty per cent, the value taken for the purpose of this rule shall be an amount not less than thirty per cent of minimum of the time scale of basic salary or the basic salary where there is no time scale. (This proviso added vide SRO 716(1)/2008 dated 2.7.2008)

i. **RULE – 5 of INCOME TAX ORDINANCE 2002,**

VALUATION OF CONVEYANCE:

[Taxation of motor vehicle if used partly for personal and partly for business purpose or wholly for Private use]

In case motor vehicle provided by the employer is used partly or exclusively for personal or private use, addition in income will be made as under;

| Valuation when; | | | |
|-------------------------|--------------------------------------------------------------------------|---------------------------------------------------------------------------------------------------------------------------------------|-------------------------------------------------------------------------------------|
| Wholly for Private Use. | a) | Where motor vehicle is owned by employer. | 10% of the cost to the employer for acquiring the motor vehicle. |
| | b) | Where motor vehicle is taken on lease by the employer. | 10% of the fair market value of the motor vehicle at the commencement of the lease. |
| Partly for Private Use. | The amount to be included in the salary on this account shall be 5% of ; | | |
| | a) | cost of the employer for acquiring the motor vehicle | |
| | b) | The fair market value of the motor vehicle at the commencement of the lease (if the motor vehicle is taken on lease by the employer.) | |

2. OTHER BENEFITS.

| | | |
|-------------------------------------------|------|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| To be added in Income - Section 13 | (09) | Any obligation to pay or repay amount owing waived by the employer. |
| | (10) | Any obligation to repay to any other person is paid by employer. |
| | (11) | Transfer of any property or services provided by employer to employee. |
| | (05) | The services of house keeper, driver, gardner or other domestic assistance provided by the employer shall be included in the total salary paid as reduced by any amount recovered by the employer. |
| | (13) | Fair market value of other benefits or perquisites as reduced by the amount recovered by the employer is to be added. |

3. OTHER PROVISIONS.

| | | |
|----------------------------------------------|--------------------------|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Concessional Loans | S.13(7) | Loan provided on or after 01.07.2002. to an employee. Difference between rate charged and benchmark rate shall be added. Benchmark [1% above the rate applicable in immediately preceding tax year] [Sec 13(14) (ii)] Provided such perquisite are exempted in the hands of employee, in the case of earning of interest is waived by the employee on his account with the employer for example Provident Fund or any other Fund etc.. |
| Tax on Tax | S.12(3) | Tax paid by the employer on behalf of the employee on or after 1st July, 2002 is to be grossed up to compute the tax liability of the employee. |
| Employee share scheme | S.14 | Mere right or option to acquire share is not chargeable to tax. |
| | | When shares actually issued the difference between the market value of shares and amount paid by employee is to be added. |
| | | If shares are subject to restriction on transfer, the difference will be added when the restriction ends. |
| | | If employee disposes of the shares despite restriction the addition will be made at the time of disposal |
| | | If employee disposes of the right or option to acquire the shares, gain shall be included in the salary. |
| Payment on termination of employment. | S.12 (2) (e) (iii) | To be included in salary; The employee by notice in writing to Commissioner may opt to be taxed at an average rate of tax for the |

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| | | preceding three years. Option to be exercised by the due date for filing of return. |
| Salary paid in arrears | S.12 (7) | If arrear results in taxation at higher rate, the employee by notice in writing to the Commissioner may opt for the amount to be taxed at the rates applicable to the year to which the salary relates. Option to be exercised by the due date for filing the return. |

4. EXEMPTED ALLOWANCES.

| | | |
|------------------------------------------------|--------------------------|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Flying Allowance | C.(1) of Pt III | Any amount received as flying allowance by Pilots, Flight Engineers and Navigators of Pakistan Armed Forces, Pakistani Airlines or Civil Aviation Authority and Junior Commissioned Officers of other ranks of Pakistan Armed Forces. Flying allowance to be taxed as a separate block of income @ 25% effective tax year 2007, [CBR Circular No. 03 of 2006 dated 11.07.2006] |
| Medical Allowance | C.(139) (a)& (b) of Pt I | 1. Reimbursement of medical charges or hospitalization charges or both is exempted from tax if: it is provided for under the terms of employer's employment agreement. the employee provides NTN of the hospital or clinic and medical or hospital bills are also certified and attested by the employer. 2. Medical Allowance received in cash is exempt upto 10% of Basic Salary. |
| Perquisites carrying zero marginal cost | C.(53) of Pt I | Following perquisites (or any other perquisites notified by CBR) provided by employers for which they do not have to bear any marginal costs have been exempted in the hands of employees: -- Free or concessional passage provided by transporters including airlines to employees (including members of household and dependents). -- Free or subsidized food provided by hotels and restaurants during duty hours. -- Free or subsidized education provided by educational institutions' to the children of employees. -- Free or subsidized medical treatment provided by a hospital or clinic to its employees. -- Any other perquisite or benefit for which the |

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|--|--|-------------------------------------------------------------------------------------------------------------------|
| | | employer does not have to bear any marginal cost as notified by FBR. [w.e.f. tax year 2006 vide Finance Act 2005] |
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PAYMENT OF SALARY THROUGH CHEQUES (Sec.21 (m))

For the purpose of making payment through crossed cheque or direct transfer of the funds to the employee's bank account the limit is Rs.15,000/- .

SENIOR CITIZENS: CLAUSE (1A) OF PART III OF SECOND SCHEDULE:

If the taxable income of a taxpayer aged 60 or above on the first day of the tax year is upto Rs.1,000,000/- his tax liability on such income shall be reduced by 50% .**This clause is equally applicable to a salaried or non-salaried taxpayer.**

1. ADMISSIBLE DEDUCTION.

The salaried persons are allowed to deduct the following payments from their Total Income;

| | | |
|-----------------------------|-----------------------------------------|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| ZAKAT. | U/S 60 | Zakat paid to Zakat Fund is allowable deduction |
| | U/S 60(2) / U/S 40(2) | Zakat deducted from Profit on Debts is allowable against such Profit on debts only. |
| | U/S 40(4) | If Zakat is deductible in computing Income under any other head of Income, no deduction of Zakat from total Income is allowable. |
| | | Note: Zakat deducted from dividend is allowable. |
| PROFESSIONAL FEE. | 16-IT of 1967 | Professional fee paid by non-practicing Professionals to retain their Professional Qualification [C.No. 13 [®] IT-1/80 dated 18.12.1986]. This Circular has not been withdrawn hence it is still valid U/S 239(1) of I.T.Ord. 2001 |
| CHARITABLE DONATION. | Clause 61 of Part I of Second Schedule. | Donation paid to charitable institutions' approved under the Clause 61 of Part I of 2nd Schedule maximum 30% of Taxable Income is allowed to be deducted directly from the total income. |

2. MISCELLANEOUS.

| | | |
|------------------------|-------------------------|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Senior Citizens | (1A) of Part III | If taxable income of taxpayer aged 60 years on 1st day of July is 2011 1,000,000/- Tax liability to be reduced by 50% |
| Pension | (8) of Part I | Pension (not working with the same employer in any capacity) |
| | | Irrespective of age of retirement.....Exempted. |
| | | Person who retire and rejoin on |
| | | Contract basis or otherwise.....Taxable. |
| | | If a person received more than one pension the exemption will be applicable to the highest of pension received. |
| Capital Gains | C. (110) | Income from sale of: |
| | | - Moradabad certificates |
| | | - any instrument of redeemable capital as defined in the CO 1984 listed on any stock exchange in Pakistan |
| | | - shares of a public company (as defined in sub-section (4) of section 2, and the |
| | | - PTC vouchers issued by Govt. of Pakistan |
| | | Shall be taxed as a separate block of income @ as specified in division VII Part-I of 1st Schedule no capital gain tax shall be chargeable on disposal of securities held for a period of more than one year |
| Provident Fund | C. (32) & (23) of Pt. I | Accumulated balance due and becoming payable from Provident Fund to which P.F. Act, 1925 applies or an approved P.F. is exempted. |
| Gratuity Fund | C. (13) & | Exempted- |
| | (25) of | - Received by employees of Govt. LA, Statutory body or Corp. |
| | Pt. I | - Received from approved gratuity fund |
| | | - Received under any approved scheme exempted upto Rs. 200,000/- |
| | | - Received by other employees exempted 50% or Rs. 75,000/- whichever is less. |

3. ADJUSTMENT OF TAX CREDIT AND WHT;

- A. Adjustment of With-Holding Tax (WHT).
- B. Reduction in Tax liability.

C. Tax Credit.**A. ADJUSTMENT OF WITH-HOLDING TAX (WHT).**

- i. of the Telephone Bill if he/she is the subscriber of Telephone including Mobile Phone under section 236.
- ii. Motor Vehicle tax if he/she is an owner of the motor vehicle and purchase of cars under section 231B.
- iii. Tax deducted on Cash withdrawals under section 231A.

B. REDUCTION IN TAX LIABILITY.**- Full time teachers and researchers**

Clause 2 of Part III Vide Finance Act 2007; 75% of tax payable is reduced in case of;

- i. Full time teacher and researcher employed in a non-profit educational or research institution.
- ii. Including Government training and research institution.

The institution should be duly recognized by a Board of Education or University or Higher Education Commission.

C. TAX CREDIT.

The gross tax liability computed under any of the above compositions will be reduced by taking into effect of the following, as relevant, to arrive at the net tax liability of the salaried taxpayer for the tax year;

- i. Tax credit for **Charitable Donations** to approved Non-Profit Organization – **U/S 61.**
 - (a) Tax credit for **Investment in Shares**, cost of new shares acquired – **U/S 62** or
 - (b) Tax credited for life insurance premium paid to insurance company registered by the securities & exchange commission of Pakistan under the insurance ordinance 2000
- ii. Tax credit for Contributions or Premium paid to **an Approved Pension Funds** – **U/S 63.**
- iii. Tax credit for **Interest paid on Housing Loan** to bank or non-banking financial institutions on utilization of loan for construction of new house or acquisition of new house – **U/S 64.**

Section 149(1) of the Finance Act, 2007, has been amended to **Permit Employers** to allow **Tax Credit** while computing the monthly tax liability of a salaried employee.

The Admissible adjustment and Tax Credit will be allowed by the employer subject to production of relevant evidences by the employee.

TAX CREDIT

1.1 Charitable Donation u/s. 61.

A taxpayer is entitled to reduction (tax credit) in his tax liability for donations made to approved non-profit organizations, and Government educational institutions or hospitals or relief funds.

Can be ascertained on the basis of the following example;

Example:

A salaried individual donated Rs. 1,800,000 to an approved non-profit organization during a tax year. His taxable income for the year amounting to Rs. 5,000,000 resulting in a gross tax liability of Rs. 1,000,000. The amount of tax credit will be calculated as under:

| | | |
|------------------------------------|-------------------------------|-----------------------------------------|
| Tax Credit | (A / B) x C | |
| Tax for the year | 1,000,000.00 = A | |
| Taxable Income for the year | 5,000,000.00 = B | |
| 30% of Taxable Income | 1,500,000.00 | } = C (Whichever is lower from the two) |
| Amount of Donation | 1,800,000.00 | |
| Tax Credit (A/B) x C = | 1,000,000.00 / 5,000,000.00 X | 1,500,000.00 |
| Amount of Tax Credit. | Rs. 300,000.00 | |

Charitable Donations. Under Clause 61 To Second Schedule

However, if the donation is made to the Institutions/Organization mentioned under clause 61 of second schedule of the Income Tax ordinance 2001. such as, Funds for Retarded and Handicapped children, National trust fund for the Disabled, Al-Shifa Trust, Aga Khan Development Network etc then the amount of donation made is fully exempt from Tax. Below is an example. Explaining the working of Income Tax.

| | |
|----------------------------------------------------------------|--------------------|
| Total Income | 50,00,000/- |
| less Donation made to clause 61 of 2 nd schedule | 18,00,000/- |
| Taxable Income | <u>32,00,000/-</u> |
| Income Tax Payable on Rs.30,00,000/- @ 17.50% | <u>560,000/-</u> |

1.2 Investment in Shares u/s. 62.

Tax payer is entitled to tax credit for investment in new shares of a public company listed on a stock exchange in Pakistan or shares acquired from the Privatization Commission of Pakistan.

This can be ascertained on the basis of following example;

Example:

A salaried individual purchased 10,000 new shares of a listed company costing Rs. 500,000. His taxable income for the tax year amounted to Rs. 4,500,000 and his tax liability amounted to Rs. 832,500. The amount of tax Credit will be calculated as under:

| | | |
|------------------------------------|-----------------------------|------------------------------------------------|
| Tax Credit | (A / B) x C | |
| Tax for the year | 832,500.00 = A | |
| Taxable Income for the year | 4,500,000.00 = B | |
| 10% of Taxable Income | 450,000.00 | } = C (Whichever is lower from the two) |
| Amount of Investment | 500,000.00 | |
| Tax Credit (A/B) x C = | 832,500.00 / 4,500,000.00 X | 500,000.00 |
| Amount of Tax Credit. | Rs. 92,500.00 | |

Wealth Statement is required to be filed if the Total Income is Rs. 1,000,000/- or more. Previously it was Rs. 500,000/-.

Now under the law instead of Quarterly Statement of Tax deduction, a monthly Statement of Tax deduction shall be filed from 1st. July 2011 it means that the Monthly Statement of Tax deducted for the month July 2011 will be filed on or before August 15th, 2011. Moreover, while filing the Monthly Statement both the N.T.N. No. and C.N.I.C. No. of employees should be mentioned?

A new sub-clause (6) to Section 165 has been inserted by virtue of which every employer has to file annual Statement of Tax Deduction even where his employee's annual salary is above Rs.300,000/- or more. As the Taxable limit has increased from Rs.300,000/- to Rs.350,000/- the employees getting annual salary below the threshold limit i.e. Rs.350,000/- their names will be included in the Annual Statement of Deduction of Tax.

1.3 Contribution to an approved pension fund u/s. 63.

A Pakistani salaried individual is entitled to tax credit for contribution to a pension fund scheme approved under the Voluntary Pension System Rules, 2005.

Tax Credit can be ascertained on the basis of following example:

Example:

A salaried individual who is 50 years of age pays a premium of Rs. 700,000 during a tax year to an approved pension fund. His taxable income for the tax year is Rs. 3,000,000 and his gross tax liability amounts to Rs. 480,000. The amount of tax credit will be calculated as follows:

| | | |
|------------------------------------|-----------------------------|------------------------------------------------------------------------------------------------------------------|
| Tax Credit | (A/B) x C | |
| Tax for the year | 480,000.00 = A | |
| Taxable Income for the year | 3,000,000.00 = B | |
| Restricted Amount | 500,000.00 | (Restricted to Rs. 500,000 or maximum of 50% of Taxable Income or Preceding Year, Whichever is lower of the two) |
| Amount Contributed | 700,000.00 | |
| Tax Credit (A/B) x C = | 480,000.00 / 3,000,000.00 X | 500,000.00 |
| Amount of Tax Credit. | Rs. 80,000.00 | |

1.4 Loan for purchase of construction of house u/s. 64.

A taxpayer is entitled to credit for interest paid on loan obtained from any of the following organizations or entities for construction or acquisition of a house:

- Scheduled banks.
- Non-banking finance companies.
- Local authorities.
- Statutory bodies such as House Building Finance Corporation.
- Companies quoted on stock exchange.

The amount of tax credit can be ascertained on the basis of the following example:

Example

A salaried individual has paid Rs. 1,000,000 during a tax year as interest on loan from a scheduled bank for purchase of a house. His taxable income for the tax year is Rs. 6,000,000 and his gross tax liability amounts to Rs. 1,140,000. The amount of tax credit will be calculated as follows:

| | | |
|------------------------------------|-------------------------------|--------------------------------------------------------------------------------------|
| Tax Credit | (A/B) x C | |
| Tax for the year | 1,140,000.00 = A | |
| Taxable Income for the year | 6,000,000.00 = B | |
| Markup Paid | 1,000,000.00 | (Restricted to Rs. 500,000 or 40% of Taxable Income whichever is lower of the three) |
| 40% of Taxable Income | 2,400,000.00 | |
| Restricted Amount | 500,000.00 | |
| Tax Credit (A/B) x C = | 1,140,000.00 / 6,000,000.00 X | 500,000.00 |
| Amount of Tax Credit. | Rs. 95,000.00 | |

All the amendments are effective from 1st. July 2011 i.e. Tax year 2012. The tax rates for the Tax Year 2011 and 2012 are as under:-

1. Taxable Limit enhanced from Rs. 300,00 to Rs. 350,000/-

SALARIED INDIVIDUALS:

| S # | Taxable Income | Rates 2011 | Rates 2012 |
|-----|--------------------------------------------------------------------------------|---------------|---------------|
| 1. | Where taxable income does not exceed Rs.300,000 | 0% | 0% |
| 2. | Where the taxable income exceeds Rs.300,000 but does not exceed Rs.350,000 | 0.75% | 0% |
| 3. | Where the taxable income exceeds Rs. 350,000 but does not exceed Rs.400,000 | 1.50% | 1.50% |
| 4. | Where the taxable income exceeds Rs.400,000 but does not exceed Rs.450,000 | 2.50% | 2.50% |
| 5. | Where the taxable income exceeds Rs.450,000 but does not exceed Rs.550,000 | 3.50% | 3.50% |
| 6. | Where the taxable income exceeds Rs.550,000 but does not exceed Rs.650,000 | 4.50% | 4.50% |
| 7. | Where the taxable income exceeds Rs.650,000 but does not exceed Rs.750,000 | 6.00% | 6.00% |
| 8. | Where the taxable income exceeds Rs.750,000 but does not exceed Rs.900,000 | 7.50% | 7.50% |
| 9. | Where the taxable income exceeds Rs.900,000 but does not exceed Rs.1,050,000 | 9.00% | 9.00% |
| 10. | Where the taxable income exceeds Rs.1,050,000 but does not exceed Rs.1,200,000 | 10.00% | 10.00% |
| 11. | Where the taxable income exceeds Rs.1,200,000 but does not exceed Rs.1,450,000 | 11.00% | 11.00% |
| 12. | Where the taxable income exceeds Rs.1,450,000 but does not exceed Rs.1,700,000 | 12.50% | 12.50% |
| 13. | Where the taxable income exceeds Rs.1,700,000 but does not exceed Rs.1,950,000 | 14.00% | 14.00% |
| 14. | Where the taxable income exceeds Rs.1,950,000 but does not exceed Rs.2,250,000 | 15.00% | 15.00% |
| 15. | Where the taxable income exceeds Rs.2,250,000 but does not exceed Rs.2,850,000 | 16.00% | 16.00% |

| | | | |
|-----|--------------------------------------------------------------------------------|--------|--------|
| 16. | Where the taxable income exceeds Rs.2,850,000 but does not exceed Rs.3,550,000 | 17.50% | 17.50% |
| 17. | Where the taxable income exceeds Rs.3,550,000 but does not exceed Rs.4,550,000 | 18.50% | 18.50% |
| 18. | Where the taxable income exceeds Rs.4,550,000 | 20.00% | 20.00% |

Provided further that where the total income of a taxpayer marginally exceeds the maximum limit of a slab in the table, the income tax payable shall be the tax payable on the maximum of that slab plus an amount equal to

| Total Income does not exceed | Increase in tax not to exceed tax payable on the maximum of the relevant slab plus |
|------------------------------|------------------------------------------------------------------------------------|
| Rs. 550,000 | 20% |
| Rs. 1,050,000 | 30% |
| Rs. 2,250,000 | 40% |
| Rs. 4,550,000 | 50% |
| Over Rs. 4,550,000 | 60% |