

TAX UPDATE

An Update on

Taxability of Salary

Under the Income Tax Ordinance, 2001 & Income Tax Rules, 2002

(Applicable w.e.f. July 1, 2010,

as proposed vide the Finance Bill, 2010)

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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 under the Income Tax Ordinance, 2001 and Income Tax Rules, 2002, taking account of the proposals vide the Finance Bill, 2010 (the Bill).

The information and elaborations as contained herein are general in nature and based on our interpretation of the applicable statute and proposals for significant amendments vide the Bill, to be enacted vide the Finance Act, 2010, becoming effective from the tax year 2011, with or without modification.

As such nothing contained herein should be taken as legal advice in a given case and Tariq Abdul Ghani & Co. does not accept any responsibility for any loss arising from any action taken or not taken based on this document.

June 8, 2010

Significant changes proposed vide the Finance Bill, 2010

Relief Measures

Basic Exemption Limit for salaried taxpayers is proposed to be increased to Rs. 300,000 from existing Rs. 200,000.

It has been proposed to increase in income threshold for **Senior Citizens** from existing Rs. 750,000 to Rs. 1,000,000 for computing reduction in tax liability.

Revenue Measures

Increase in tax rate for higher income bracket cases: A category of salary range between Rs. 4,550,001 to 8,650,000, subjected to tax at 19%, has been proposed to be excluded from tax slabs and, thereby, subjecting this range to the upper tax rate of 20%.

Other Measures

The concept of distinction for higher basic exemption limit in case of **Women Taxpayers** is proposed to be abolished.

Salaried taxpayers with total 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. It has now been proposed that the date of filing be changed to **August 31**, instead of September 30, each year.

Exempt allowances & benefits

Description	Condition/ Limit
Medical benefit or reimbursement*	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.
Medical Allowance (without medical facility)	Exempt up to 10% of basic salary.
Special allowance or benefit (other than entertainment or conveyance allowance)	If granted to meet expenses wholly and necessarily incurred in the performance of duties is fully exempt.
Employer's contribution to provident fund	Exempt up to lower of Rs.100,000 and 10% of salary, such that the amount does not exceed employee's contributions.
Gratuity/ superannuation/ Commutation of Pension (received in Pakistan by residents)	On retirement/ death
	Receipts from
	Treatment
	Approved Funds Fully Exempt
	Approved Schemes Exempt up to Rs.200,000
	Other cases
	Exempt up to lower of 50% of the amount or Rs. 75,000. Residual amount to be taxed at the current rate of tax.
Pension	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
Utilities (water, gas, electricity allowance)	Fully Taxable
House rent allowance	Fully Taxable
Accommodation (whether furnished or not)	45% of basic salary to be included in taxable salary.
Leave Fare Assistance	Fully Taxable
Salary of domestic servant (house-keeper, gardener, etc.)	Fully Taxable
Capital receipt on termination of employment	Fully chargeable to tax
Tax paid by the employer	Salary is to be grossed-up by tax paid by the employer on behalf of the employee.
Interest-free loans to employees or loans at concessional rates	Difference between the benchmark rate and the rate charged is taxable. The rate was fixed at 5% for the tax year 2003 with 1% annual increment until further notification. Thus the rate for tax year 2011 is 13% . However, the above difference (concession) is not taxable in case an employee waives interest on his account with the employer.
Conveyance allowance (all types and cases)	Fully taxable
Motor vehicle (owned and maintained by employer)	Partly for private use: Taxable at 5% of cost/ FMV at the time of commencement of lease. Wholly for private use: 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>Value of right/ option 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>Amount taxable against disposal of right/ option is the difference between:</p> <p>(a) consideration for right/ option; and (b) cost in respect of said right/ option.</p> <p>Amount taxable at acquisition of shares is difference between:</p> <p>(a) fair value of shares; and (b) sum paid against acquisition of shares.</p> <p>If shares acquired are under restriction as to transfer, the amount is taxable 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 of)	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	Actual annual contribution	Amount paid
		10% of taxable income	20% of taxable income - Note3	50% of taxable income
	30% of taxable income	Rs. 300,000/-	Rs. 500,000/-	Rs. 750,000/-

Note1: Includes donations not covered under 2nd 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	Timeline for Filing
Where salary income is less than Rs.500,000 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	N/A
Where salary income is less than Rs.500,000 and the taxpayer also has income/ loss from any other source	The taxpayer needs to file annual tax return manually and a wealth statement (in case the total income is Rs.500,000 or more)	30 th day of September falling next to the tax year
Where salary income is Rs.500,000 or more (irrespective of the fact whether or not there are some other income sources)	The taxpayer needs to electronically file the annual tax return along with a wealth statement	31 st day of August falling next to the tax year

Exemption limit

Rs. 300,000

Tax rates

Taxable Income (Rs.)		Rate of Tax (%)	Taxable Income (Rs.)		Rate of Tax (%)
From	Up to		From	Up to	
300,001	350,000	0.75%	1,200,001	1,450,000	11.00%
350,001	400,000	1.50%	1,450,001	1,700,000	12.50%
400,001	450,000	2.50%	1,700,001	1,950,000	14.00%
450,001	550,000	3.50%	1,950,001	2,250,000	15.00%
550,001	650,000	4.50%	2,250,001	2,850,000	16.00%
650,001	750,000	6.00%	2,850,001	3,550,000	17.50%
750,001	900,000	7.50%	3,550,001	4,550,000	18.50%
900,001	1,050,000	9.00%	Above 4,550,000		20.00%
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.1,000,000/-
Full time teachers & researchers	75%	Employed in a recognized non profit education or research institution (including government training & research institutions)

Worked examples – Computation for the Tax Year 2011

Case	Gross Salary	Income Tax Payable							
		Without Considering Marginal Limit		Considering Marginal Limit				Total (B)	Lower of (A) and (B)
		(A)	Maximum Tax on Previous Slab	Tax on Marginal Amount	(B)				
Amount (Rs.)	Rate	Amount (Rs.)	Rate	Amount (Rs.)	Rate	Amount (Rs.)	Amount (Rs.)	Amount (Rs.)	
1	300,000	0.00%	-	0.00%	-	20.00%	-	-	-
2	325,000	0.75%	2,438	0.00%	-	20.00%	5,000	5,000	2,438
3	360,000	1.50%	5,400	0.75%	2,625	20.00%	2,000	4,625	4,625
4	425,000	2.50%	10,625	1.50%	6,000	20.00%	5,000	11,000	10,625
5	475,000	3.50%	16,625	2.50%	11,250	20.00%	5,000	16,250	16,250
6	600,000	4.50%	27,000	3.50%	19,250	30.00%	15,000	34,250	27,000
7	675,000	6.00%	40,500	4.50%	29,250	30.00%	7,500	36,750	36,750
8	825,000	7.50%	61,875	6.00%	45,000	30.00%	22,500	67,500	61,875
9	950,000	9.00%	85,500	7.50%	67,500	30.00%	15,000	82,500	82,500
10	1,125,000	10.00%	112,500	9.00%	94,500	40.00%	30,000	124,500	112,500
11	1,240,000	11.00%	136,400	10.00%	120,000	40.00%	16,000	136,000	136,000
12	1,575,000	12.50%	196,875	11.00%	159,500	40.00%	50,000	209,500	196,875
13	1,775,000	14.00%	248,500	12.50%	212,500	40.00%	30,000	242,500	242,500
14	2,100,000	15.00%	315,000	14.00%	273,000	40.00%	60,000	333,000	315,000
15	2,295,000	16.00%	367,200	15.00%	337,500	50.00%	22,500	360,000	360,000
16	3,200,000	17.50%	560,000	16.00%	456,000	50.00%	175,000	631,000	560,000
17	3,650,000	18.50%	675,250	17.50%	621,250	50.00%	50,000	671,250	671,250
18	4,700,000	20.00%	940,000	18.50%	841,750	60.00%	90,000	931,750	931,750
19	7,350,000	20.00%	1,470,000	18.50%	841,750	60.00%	1,680,000	2,521,750	1,470,000
20	8,700,000	20.00%	1,740,000	18.50%	841,750	60.00%	2,490,000	3,331,750	1,740,000

Tariq Abdul Ghani & Co., Chartered Accountants

Karachi Office: 173-W Block 2, P.E.C.H.S., Karachi
Phone: (92-21) 34322582-83,
34322606-07
Fax: (92-21) 34522492

Islamabad Office: 2, Street 80, G-6/4, Islamabad
Phone: (92-51) 2831322-23
Fax: (92-51) 2831123

Lahore Office: H-33, Commercial, DHA Phase 1, Lahore
Phone: (92-42) 35721631-32
Fax: (92-42) 35731127

E-mail: info@tagglobalservices.com
URL: <http://www.tagglobalservices.com>

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