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Salary Taxation

and related concepts

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Topics

- **Concept of salary and definitions**
- **General Rules**
- **Taxation of allowances and perquisites**
- **Exemptions and rebates**
- **Withholding tax and adjustments by employer**
- **Employee retirement benefits**

Salary Definitions and Concepts

Salary [section 12(2)]

means any amount received by an employee from any employment, including —

- **Any pay, wages or other remuneration**
- **Perquisites**
- **Allowances**
- **Reimbursement of expenses**
- **Profits in lieu of**
- **Pension**

Except for amount expended in the performance of employment



Salary Definitions and Concepts

Salary [section 12(5)]

includes any amount received:

- a) by the employee's employer, an associate of the employer, or by a third party under an arrangement with the employer or an associate of the employer;**
- b) by a past employer or a prospective employer; or**
- c) To the employee or to an associate of the employee or to a third party under an agreement with the employee or an associate of the employee.**

Receipt of income [section 67]

A person shall be treated as having received an amount, benefit, or perquisite if it is:

- (a) actually received by the person;**
- (b) applied on behalf of the person, at the instruction of the person or under any law; or**
- (c) made available to the person.**



Salary – General Rules

- 1) **Salary is taxable on receipt basis - [Section 12(1)]**

- 2) **For salary received in Arrears: Option available with the taxpayer to elect salary to be taxed as if it was received in a relevant tax year -[section 12(7)]**

- 3) **No deduction is allowed for any expenditure incurred by an employee in deriving salary income – [section 12 (4)]**

- 4) **Payment on termination of services may be taxed:**
 - **At the applicable tax rate for the tax year in which payment is received; or**
 - **At an average rate of tax of the employee for 3 preceding tax years, at the option of the employee.**

[section 12(6)]

Salary – Geographical source of income

- 1) Salary shall be Pakistan source if it is received from exercise of employment in Pakistan - [section 101]**
- 2) Foreign-source salary is exempt if tax is deducted in foreign country - [Section 102]**
- 3) Foreign-source salary is exempt if citizen of Pakistan leaves Pakistan and remains abroad - [section 51(2)]**

Allowances and Perquisites

- 1) **All allowances received by an employee in relation to his employment are fully taxable - [section 12(2)(c)]**
- 2) **All perquisites (benefits in kind) provided to an employee in relation to his employment are taxable at fair market value (FMV) less the amount contributed by the employee - [section 13]**
- 3) **The value of accommodation provided by an employer shall not be less than 45% of his basic salary - [Rule 4]**
- 4) **The value of conveyance provided by an employer shall be:**
 - **10% of cost of vehicle to the employer (if only for personal use);**
 - **5% of cost of vehicle to the employer (if partly for official and partly for personal use) - [Rule 5]**

Allowances and Perquisites

5) If the terms of employment provides for medical treatment / reimbursement of medical expense, the entire benefit is exempt if:

- **NTN of the hospital is mentioned on the bill; and**
- **Bills are duly verified by the employer.**

If terms of employment do not provide for any medical benefit but the employer provides such benefit / reimbursement, the exemption is upto 10% of basic salary

[Clause (139) Second Schedule]

Concessional loan

If the employer provides interest free loan or loan at a concessional rate, the amount to be included in salary will be –

- **Profit on loan at the benchmark rate; or**
- **The difference between the profit paid by the employee and the profit computed at the benchmark rate (currently 10%)**

No addition will be made in respect of the above, if the loan amount does not exceed Rs.1,000,000

[section 13(7)]

Concessional loan

Interest free loan provided Rs. 500,000

Addition in salary : Nil

loan provided with 5% p.a. interest Rs. 1,000,000

Addition in salary : Nil

loan provided with 8% p.a. interest Rs. 2,000,000

Addition in salary :

Rs. 2,000,000 @ 10% = 200,000

Rs. 2,000,000 @ 8% = 160,000

Addition in salary = 40,000

[section 13(7)]



Tax on Tax

Tax borne by the employer is a perquisite in the hands of the employee and is therefore taxable.

Salary is therefore required to be “grossed up” to determine correct taxable income. [section 12(3)]

Salary = Rs. 450,000

Tax on salary @ 2% on exceeding Rs. 400,000 = 1,000

Now add Rs. 1,000 as perquisite in salary which is additionally taxed @ 2% = Rs. 20

Now add Rs. 20 as perquisite in salary which is additionally taxed @ 2% = Rs. 0.4

$50,000/(1-0.02) = 51,1020$

Rebates / Deductible allowances

Profit on debt [section 64C]

A deductible allowance against salary income is allowed to the lower of 50% of taxable income or Rs.2 million in respect of any profit or share in rent / share in appreciation for value of house paid on a loan obtained from a scheduled bank or an NBFC, or a Government, or a listed company where the loan is utilized for construction or acquisition of a house.

Zakat [section 60]

Deductible allowance in respect of Zakat paid by a person is available to such person. However, the employer is not entitled to give any benefit of Zakat while working out taxable salary for the year and tax thereon under section 149.

Rebates / Deductible allowances

Education expenses [section 60D]

Every individual having taxable income of less than 1.5 million rupees is entitled to a deductible allowance in respect of tuition fee paid by the individual in a tax year, to the lesser of –

- 5% of the total tuition fee paid;**
- 25% of the person's taxable income for the year;**
- Rs. 60,000 per child x No. of children**

The individual would be entitled to claim the above against his taxable income.

However, the employer is not entitled to give any benefit of Zakat while working out taxable salary for the year and tax thereon under section 149.

EMPLOYEE SHARE SCHEME [section 14]

a) Option / Right Shall not be Chargeable to Tax

b) Shares:

➤ **Unrestricted**

Include amount in the year the option is exercised and Shares Acquired:

FMV of Shares on date of Issue

Less: Consideration for Shares & Share options

➤ **Restricted**

Amount shall be chargeable to tax upon the earlier of :

a) the time the employee has a free right to transfer the shares; or

b) the time the employee disposes of the shares; and

In the above case, use FMV of the earlier of date when Restrict to Transfer Expires / Disposal Date

Cost of Share will be sum of:

Consideration given by Employee for Share: XXXX

Consideration given by Employee for Right / Option XXXX



Withholding tax from salary

Withholding of tax [section 149]

- 1) Every employer (person responsible for payment) is required to withhold tax from salary**
- 2) Tax is required to be deducted at the time of payment**
- 3) The amount of tax is calculated at an average rate of tax (as provided under Part I of the First Schedule) – rates on next slide**

Income Tax Slab Rates (for tax year 2018)

S.No	Taxable Income	Rate of tax
1.	Where the taxable income does not exceed Rs.400,000	0%
2.	Where the taxable income exceeds Rs.400,000 but does not exceed Rs.500,000	2% of the amount exceeding Rs.400,000
3.	Where the taxable income exceeds Rs.500,000 but does not exceed Rs.750,000	Rs. 2000 + 5% of the amount exceeding Rs.500,000
4.	Where the taxable income exceeds Rs.750,000 but does not exceed Rs.1,400,000	Rs.14,500 + 10% of the amount exceeding Rs.750,000
5.	Where the taxable income exceeds Rs.1,400,000 but does not exceed Rs.1,500,000	Rs. 79,500 + 12.5% of the amount exceeding Rs.1,400,000
6.	Where the taxable income exceeds Rs.1,500,000 but does not exceed Rs.1,800,000	Rs. 92,000 + 15% of the amount exceeding Rs.1,500,000
7.	Where the taxable income exceeds Rs.1,800,000 but does not exceed Rs.2,500,000	Rs.137,000 + 17.5% of the amount exceeding Rs.1,800,000
8.	Where the taxable income exceeds Rs.2,500,000 but does not exceed Rs.3,000,000	Rs. 259,500 + 20% of the amount exceeding Rs.2,500,000
9.	Where the taxable income exceeds Rs.3,000,000 but does not exceed Rs.3,500,000	Rs. 359,500 + 22.5% of the amount exceeding Rs.3,000,000
10.	Where the taxable income exceeds Rs.3,500,000 but does not exceed Rs.4,000,000	Rs.472,000 + 25% of the amount exceeding Rs.3,500,000
11.	Where the taxable income exceeds Rs.4,000,000 but does not exceed Rs.7,000,000	Rs.597,000 + 27.5% of the amount exceeding Rs.4,000,000
12.	Where the taxable income exceeds Rs.7,000,000	Rs.1,422,000 + 30% of the amount exceeding Rs.7,000,000

Adjustments from withholding tax

Following adjustments can be made against the tax to be withheld by the employer as per section 149:

Tax credit on:

- (a) Donation [section 61];**
- (b) Investments in new shares [section 62];**
- (c) life insurance premium [section 62] and**
- (d) Contribution to an Approved Pension Fund [section 63].**

Tax collected from the employee under various sections such as telephone and electricity bills, cash withdrawals etc.

Exemption

Rebate for disabled person and senior citizen [Clause (1B) Part I First Schedule

50% reduction in tax liability of the following persons where taxable income other than FTR does not exceed Rs.1,000,000 –

- **The individual is a disabled person and holds a CNIC to that effect; or**
- **The age of the individual is 60 years or more on the first day of the tax year.**

Rebate for teachers/researcher [Clause (2), Part III Second Schedule

40% reduction in tax liability of an individual subject to the following conditions -

- **He/she should be a full time teacher or researcher; and**
- **He/she should be employed in:**
 - **A non-profit education or research institution recognized by HEC;**
 - **A Board of Education recognized by HEC; or**
 - **A University recognized by HEC; or**
 - **Government training and research institution**

Post Employment Benefits

- 1) **Pension - A regular payment made by the employer to employee of or above retirement age and to some widows and disabled people.**

- 2) **Gratuity - a sum of money paid to an employee at the end of a period of employment. Normally it is last drawn salary multiply by number of years in an employment**

- 3) **Provident fund - an investment fund contributed to by employees, employers, and (sometimes) the state, out of which a lump sum is provided to each employee on retirement. Normally it is 10% of monthly basic salary each contributed by employee and employer till the life of employment.**

Post Employment Benefits - Pension

- **Pension received by the citizen of Pakistan from the former employer shall be exempt from tax except where the person continues to work for the same employer or an associate of the employer.**
- **Where a person receives more than one pension, the exemption shall apply to higher of such pensions.**
- **Pension received in respect of services rendered by a member of Armed Forces of Pakistan or Federal Government or a Provincial Government is exempt from tax.**

(Clause 8,12,13, Part 1, 2nd Schedule)



Post Employment Benefits - Gratuity

- **Gratuity received from Federal/Provincial Governments is fully exempt**
- **Gratuity received from gratuity fund approved by the Commissioner is fully exempt**
- **Gratuity received from gratuity scheme approved by FBR is exempt upto Rs. 300,000**
- **Gratuity received from unapproved scheme is exempt upto 50% or Rs.75,000 which ever is higher**

Exemption in respect of unapproved gratuity shall not apply in the following cases:

- (i) Any payment not received in Pakistan**
- (ii) Any payment received by a director of a company who is not a regular employee of such company**
- (iii) Any payment received by a non-resident**
- (iv) Any gratuity received by an employee who has already received any gratuity from the same or other employer.**

(Clause 13, Part 1, 2nd Schedule)





Thank you