



KPMG Taseer Hadi & Co.
Chartered Accountants

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**
- **Taxation of Income from Property**

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 shall be treated to be received by an employee which is paid:

- 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 69]

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)]

EMPLOYEE SHARE SCHEME [section 14]

a) Option / Right Shall not be Chargeable to Tax

b) Shares:

➤ **Unrestricted**

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



Deductible allowances

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.

Profit on debt [section 60C]

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.

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.

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**

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.

Tax Credits

(a) Donation [section 61]

Donation made to prescribed organization as mentioned in section 61 including NPO, then credit is allowed upto actual donation or 30% of taxable income of individual and 20% in case of company which ever is lessor based upon formula i.e. average rate of tax.

(b) Investments in new shares & Life Insurance Policy [section 62]

If a resident person acquire new share and life insurance policy subject to condition mentioned in section 62, then credit is allowed upto actual cost of acquiring, 20% of taxable income or Rs. 2 million which ever is lessor based upon formula i.e. average rate of tax.

(d) Investment in Health Insurance [section 62A]

If a resident person paid premium on account of Health Insurance then he is entitled to tax credit subject to condition mentioned in section 62A, upto actual premium paid, 5% of taxable income or Rs. 150,000 which ever is lessor based upon formula i.e. average rate of tax.

(e) Contribution to an Approved Pension Fund [section 63]

If a eligible person paid premium to Approved Pension Fund then he is entitled to tax credit subject to condition mentioned in section 62A, upto actual premium paid or 20% of taxable income of a person depend upon his/her age and joining of Fund which ever is lessor based upon formula i.e. average rate of tax.

Income Tax Slab Rates (for tax year 2020)

S.No	Taxable Income	Rate of tax
1.	Where the taxable income does not exceed Rs. 600,000	0%
2.	Where the taxable income exceeds Rs. 600,000 but does not exceed Rs. 1,200,000	5% of the amount exceeding Rs. 600,000
3.	Where the taxable income exceeds Rs. 1,200,000 but does not exceed Rs. 1,800,000	Rs. 30,000 plus 10% of the amount exceeding Rs. 1,200,000
4.	Where the taxable income exceeds Rs.1,800,000 but does not exceed Rs. 2,500,000	Rs. 90,000 plus 15% of the amount exceeding Rs. 1,800,000
5.	Where the taxable income exceeds Rs. 2,500,000 but does not exceed Rs. 3,500,000	Rs. 195,000 plus 17.5% of the amount exceeding Rs. 2,500,000
6.	Where the taxable income exceeds Rs. 3,500,000 but does not exceed Rs. 5,000,000	Rs. 370,000 plus 20% of the amount exceeding Rs.3,500,000
7.	Where the taxable income exceeds Rs. 5,000,000 but does not exceed Rs. 8,000,000	Rs. 670,000 plus 22.5% of the amount exceeding Rs. 5,000,000
8.	Where the taxable income exceeds Rs. 8,000,000 but does not exceed Rs. 12,000,000	Rs. 1,345,000 plus 25% of the amount exceeding Rs. 8,000,000
9.	Where the taxable income exceeds Rs. 12,000,000 but does not exceed Rs. 30,000,000	Rs. 2,345,000 plus 27.5% of the amount exceeding Rs. 12,000,000
10.	Where the taxable income exceeds Rs. 30,000,000 but does not exceed Rs. 50,000,000	Rs. 7,295,000 plus 30% of the amount exceeding Rs. 30,000,000
11.	Where the taxable income exceeds Rs. 50,000,000 but does not exceed Rs. 75,000,000	Rs. 13,295,000 plus 32.5% of the amount exceeding Rs. 50,000,000
12.	Where the taxable income exceeds Rs. 75,000,000	Rs.21,420,000 plus 35% of the amount exceeding Rs. 75,000,000

Example – Salary Taxation

Mr. Umair has been working for a listed company Karachi Limited (KL) for the last many years. The details of his emoluments during the tax year ended June 30, 2020 are as under:

Basic salary (per month)	Rs. 350,000
Conveyance allowance (per month)	Rs. 50,000

In addition to the above cash emoluments, Mr. Umair was also provided with the following:

- (a) A rent free furnished accommodation with a fair market rent of Rs. 100,000 per month.
- (b) An 1500cc company maintained car, both for business and private use. The car was purchased at a fair market value of Rs. 2,000,000.

Solution – Salary Taxation

Income from Salary (Mr. Umair)	Amount in Rupees
Basic salary for twelve months ($350,000 \times 12$)	4,200,000
Conveyance allowance ($50,000 \times 12$)	600,000
Value of accommodation (45% of basic salary or fair market rent whichever is higher) ($45\% \times 4,200,000 = 1,890,000$ or $100,000 \times 12 = 1,200,000$)	1,890,000
Company maintained car ($2,000,000 \times 5\%$)	<u>100,000</u>
Total Salary income	<u>6,790,000</u>
Tax liability	
upto Rs. 5,000,000	670,000
22.5% of the amount exceeding Rs. 5,000,000 ($1,790,000 \times 22.5\%$)	<u>402,750</u>
Total Tax Liability	<u>1,072,750</u>

Exemption

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

25% 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**

This reduction not applicable to teachers of medical profession who derive income from private medical practice or who receive share of consideration received from patients.

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)

Post Employment Benefits – Provident Fund

➤ Provident Fund

Provident fund is categorized into the following three categories:

- Government provident fund
- Recognized provident fund
- Unrecognized provident fund

Provisions regarding taxability in respect of employer/employee contribution, interest credited and accumulated balance thereon is as follows:

Event	Government PF	Recognized PF	Unrecognized PF
Employee's Contribution	No treatment	No treatment	No treatment
Employer's Contribution	Exempt	Limit on employer's yearly contribution is Rs.150,000 or 1/10th of (basic salary + dearness allowance) whichever is lower	No treatment
Interest credited during the year	Exempt	Yearly interest is exempt higher of: - 16% interest rate on accumulated balance; or - 1/3rd of (basics salary + dearness allowance)	No treatment
Payment of accumulated balances	Exempt	Exempt	Only the employer's contribution and interest on accumulated balance is taxable in the year of receipt.



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Income from Property

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Income from Property

- **Income from Property [section 15(1)]**

The rent received or receivable by a person for a tax year, other than rent exempt from tax, will be chargeable to tax in that year under the ‘Income from Property.

- **“rent” means any amount received or receivable by the owner of land or a building as consideration for the use or occupation of, or the right to use or occupy, the land or building, and includes any forfeited deposit paid under a contract for the sale of land or a building but excluding the lease of a building together with plant and machinery.**

- **Income from the lease of immovable property in Pakistan shall be Pakistan source rental income. (Section 101(9))**

Income from Property

❑ How to tax

- Rent received by **companies** will be taxed on corporate rate of tax after allowing specific deductions from income from property.
- Rent received by **individuals** and **AOPs**:
 - Rent received upto Rs. 4,000,000 per annum – to be taxed on separate rate of tax without any deductions;
 - Rent received over Rs. 4,000,000 per annum – An option is given to individuals and AOPs either to pay tax under specific tax rates given for immoveable property income or allowed specific deductions as in case of the company and will be taxable under Normal tax lab rates [Division I of Part I of the First Schedule. (Recent Amendment through Finance Act, 2019)

Income from Property

➤ Deductions allowed from income from property [section 15A]

The following deductions are allowed when computing income from property:

- **Amount used for repair of the building equal to 1/5th of the rent chargeable;**
- **Any premium for insurance of the building;**
- **Any local tax, charge or rate in respect to the property or rent chargeable;**
- **Ground rent payable or paid by the company;**
- **Profit to be paid on money borrowed as a mortgage to improve the property;**
- **The amount of interest or profit paid on the mortgage or charge of the property respectively;**

Income from Property

- Share in rent and share towards appreciation in the value of property to HBFC / scheduled bank under a scheme of investment in property in the year under that scheme;
- Any administration and **collection charges not exceeding 6%** of the rent chargeable to tax computed before any deduction;
- Any expenditure incurred as **legal expenditure** in relation to litigation with respect to the property in court;
- Amount of unpaid rent which is irrecoverable. For such deduction to be allowed the company needs to establish that:
 - tenancy was bona fide, the defaulting tenant does not reside in any of the properties of the same owner and steps have been taken to compel the tenant to vacate the property;
 - The person has either taken all legal recourse to avail unpaid rent or believes such an attempt would be futile: and
 - The rent has already been included in income from property and tax has been paid on the income inclusive of the bad rent.

Tax Slab Rates (for tax year 2020)

- **Individuals and AOP's are taxed at the same rates (subject to exemption, if income under this head not exceeding Rs. 200,000 in a tax year and a person not deriving income under any other head). Whereas companies are taxed at their corporate rates.**

S.No	Gross amount of Rent	Rate of tax
1.	Where the gross amount of rent does not exceed Rs.200,000.	Nil
2.	Where the gross amount of rent exceeds Rs.200,000 but does not exceed Rs.600,000.	5% of the gross amount exceeding Rs.200,000.
3.	Where the gross amount of rent exceeds Rs.600,000 but does not exceed Rs.1,000,000.	Rs.20,000 + 10% of the gross amount exceeding Rs.600,000.
4.	Where the gross amount of rent exceeds Rs.1,000,000 but does not exceed Rs.2,000,000.	Rs.60,000 + 15 % of the gross amount exceeding Rs.1,000,000.
5.	Where the gross amount of rent exceeds Rs.2,000,000 but does not exceed Rs.4,000,000.	Rs.210,000 + 20% of the gross amount exceeding Rs.2,000,000
6.	Where the gross amount of rent exceeds Rs.4,000,000 but does not exceed Rs.6,000,000.	Rs.610,000 + 25% of the gross amount exceeding Rs.4,000,000
7.	Where the gross amount of rent exceeds Rs.6,000,000 but does not exceed Rs.8,000,000.	Rs.1,110,000 + 30% of the gross amount exceeding Rs.6,000,000
8.	Where the gross amount of rent exceeds Rs.8,000,000.	Rs.1,710,000 + 35% of the gross amount exceeding Rs.8,000,000

Income from Property

➤ **Reversal of Deductions allowed from income from property [section 15A]**

- **Any recovery of unpaid rent claimed as a deduction, shall be chargeable to tax in the tax year in which it is recovered.**
- **If the company does not pay the liability within three years of claiming the deduction, the amount of liability unpaid shall be charged to tax immediately after the end of the three year period. However, the unpaid liability charged for tax is paid either fully or partially, then the company can claim the amount paid as deduction for the tax year when it is paid.**

Income from Property

- **Non adjustable amounts received in relation to buildings [section 16]**
 - **Amounts received from a tenant not adjustable against rent will be charged under the head income from property in equal proportions over 10 years. (Section 16(1))**
 - **Where the amount received as advance is returned, it shall not be chargeable to tax in the year it is returned and any year subsequently. (Section 16(2))**
 - **Where a new tenant replaces the old one and pays an advance, their amount will be reduced by the advance repaid to the previous tenant on which tax has been paid and it will then be chargeable to tax in equal proportions over the next 10 years, in the same way as the previous advance. (Section 16(3))**

Example - Income from Property

Mr. Haris had let out the property to Mr. Azam for a sum of Rs 150,000 per month in July 2016. Mr. Azam has paid a sum of Rs 500,000 as non-adjustable deposit.

After the expiry of two years, Mr. Azam vacated the premises and Mr. Haris returned the deposit to Mr. Azam. Thereafter, Mr. Shehryar acquired the possession on the same rental amount. However, the amount of nonadjustable deposit was increased to Rs 600,000.

Compute the gross income of Mr. Haris from the said property and related tax liability for the years 2020.

Solution - Income from Property

Income from Property for the year 2020

Particulars		Amount in Rupees
Rent $150,000 \times 12$		1,800,000
Add: Un-adjustable deposit	600,000	
Less: Already recognised income in the last two years ($\text{Rs.}50,000 \times 2 \text{ years}$)	<u>100,000</u>	
Balance Chargeable deposit in 10 years	500,000/10	<u>50,000</u>
Total Gross rental Income		<u>1,850,000</u>
<u>Tax Liability under the head income from Property</u>		
Income upto Rs. 1,000,000	60,000	
Exceeding Rs. 1,000,000. ($850,000 \times 15\%$)	<u>127,500</u>	
Total tax liability for tax year 2020		<u>187,500</u>



Thank you