**Will the salaried class be taxed more?**

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The salaried class of Pakistan has always played a pivotal role in contributing towards national revenue. Yet, this class has always remained a soft target for the stakeholders. The reason behind this strategy is that the tax collection for the salaried class is done majorly by employers under section 149 of the Income Tax Ordinance, 2001 [the Ordinance].

To increase the overall revenue, often the first tactic that the government opts for is to decrease the benefits offered to the salaried class. This year IMF asked the government to increase the revenue it generates from this class, which stands at PKR 129 billion currently, to PKR 305 billion which means an overall increase by at least PKR 176 billion. While this demand was technically not possible for the government to accept, it agreed to increase it by PKR 10 billion – by withdrawing certain exemptions.

If we look at the stats of tax collection and tax expenditure, it shows that in the fiscal year 2019-20, the tax expenditure stood at PKR 1,314.27 billion as against the collection of PKR 3,997.4 billion which is 32.87 percent of the total collection, while, in comparison with GDP it is 3.2 percent. The share of income tax in total tax expenditure is PKR 448.046 billion which is 34.1 percent. While the relief that is being provided by the government in form of tax expenditure is in the form of allowances of PKR 37.318 billion at 8.3 percent, tax credits of PKR 105.342 billion at 23.51 percent, exemptions from the total income of PKR 267.115 billion at 59.62 percent, reduction in tax rates of PKR 0.124 billion at 0.028 percent, reduction in a tax liability of PKR 2.839 billion at 0.63 percent, exemption from specific provisions of PKR 2.687 billion at 0.6 percent and other tax expenditures amounting to PKR 32.621 billion at 7.3 percent respectively.

In all, ten amendments that pertain to salary taxation have been proposed in the Finance Bill 2021 to reduce the above tax expenditures being provided. One pertains to insertion of explanation, six pertains to the withdrawal of benefits while the remaining three pertains to enhancement of taxation of specific benefits.

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The explanation has been inserted in clause (c) of sub-section 2 of section 12 of the Ordinance. The said provision specifies that if any amount in form of allowance is given by an employer to an employee it shall be subject to tax except when allowance solely expended in the performance of the employee’s duties of employment. Now the explanation is proposed which relates to the clarification regarding what exactly is meant by the ‘allowance solely expended in the performance of employee’s duty of employment, in order to restrict the scope of this provision. Anything out of the ambit of this would now be subject to tax including the allowance which is paid in monthly salary on a fixed basis or percentage of salary or allowance which is not wholly, exclusively, necessarily, or actually spent on behalf of the employer.

The six clauses are proposed to be withdrawn, five of which relate to exemptions from total income under Part I of the second Schedule and one from a reduction in tax liability under Part III of the second schedule of the Ordinance.

There are five different types of exemptions on salary income of the salaried class which are proposed to be withdrawn under Finance Bill 2021, firstly, the exempt salary income of the Pakistani seafarer, working on Pakistan flag vessels for one hundred and eighty-three days or more during a tax year; or a Pakistani seafarer working on a foreign vessel provided that such income is remitted to Pakistan, not later than two months of the relevant tax year, through normal banking channels. This withdrawal will add PKR 67.68 million to the national kitty.

Secondly, any special allowance or benefit (not being entertainment or conveyance allowance) or other perquisites within the meaning of section 12 specially granted to meet expenses wholly and necessarily incurred in the performance of the duties of an office or employment of profit which is at present exempt shall be withdrawn and this will give the government additional revenue of PKR 947.76 million.

The third exemption which is proposed to be withdrawn pertains to the income of a newspaper employee representing Local Travelling Allowance paid in accordance with the decision of the Third Wage Board for Newspaper Employees constituted under the Newspaper Employees (Conditions of Service) Act, 1973, published in Part II of the Gazette of Pakistan, Extraordinary, dated the 28th June 1980.

Fourthly, if the employee receives employment-related perquisites including food, education, medical treatment, and any other perquisites by an employer for free or at subsidized rates then it is exempt from tax. However, if withdrawn, it would add tax revenue of PKR 134.16 million.

The most important withdrawal which is of quite a concern among the salaried class and simultaneously in the interest of tax revenue is regarding the medical allowance and reimbursement which could add PKR 1.825 billion to the national treasury. In case, if an employee only receives a medical allowance, it is exempt up to ten percent of the basic salary. If an employee only receives medical treatment or hospitalization or reimbursement, then the entire amount shall be exempt subject to the condition if such benefit is in accordance with the terms of the employment and National Tax Number of the hospital or the clinic, as the case may be, is given and the employer also certifies and attests the medical or hospital bills. In case if both are provided by the employer, then later shall be exempt if it is as per terms of employment and the allowance shall be fully taxable, whereas if later is not in accordance with terms of employment the amount becomes fully taxable and allowance is exempt up to ten percent of basic salary. The impact of the withdrawal of this exemption shall also be on health insurance which in common parlance would be taxable when hospitalization or treatment or reimbursement would be availed, currently being exempt due to the exemption available in the stated clause.

Moreover, the historic reduction in tax liability as available to the full-time teachers or researchers of twenty-five percent of tax liability on taxable salary is also proposed to be withdrawn as specified by the Finance Bill 2021 mentioning clause 2, Part III of the second schedule which could increase the revenue by PKR 2.425 billion. However, the government after issuing the Income Tax (Second Amendment) Ordinance, 2021 also clarified that it doesn’t intend to take back this benefit. Now, whether the same would be the case here, is quite premature to say.

Employees receiving the amount from the provident fund under-recognized provident fund or under the Provident Funds Act, 1925 are presently exempt from tax. Now, for payments representing profit on debt earned on provident fund contributions exceeding rupees five hundred thousand this exemption shall not be available which means that the profit on debt exceeding rupees five hundred thousand shall be chargeable to tax at ten percent as a separate block of income and the person making payment shall deduct tax at the said rate. This alone would add PKR 6.933 billion to the national exchequer.

In furtherance of the above, any withdrawal of accumulated balance from an approved pension fund that represents the transfer of the balance of the approved provident fund to the said approved pension fund under the Voluntary Pension System Rules, 2005 is exempt from tax. Now, it is proposed that this exemption shall not be available to the payments representing profit on debt earned on accumulated balance in an approved pension fund. This profit on debt shall be chargeable to tax ten percent as a separate block of income, thereby, increasing tax revenue by PKR 147.75 million.

Having said above, the government shall reconsider its decision of overstretching its revenue collection from the salaried class although an easier target as compared to other sources due to the fact that they work in observable and formalized systems. The tax base shall be widened instead of tax depth which could be done by exploring new avenues of tax collection rather than hammering the same class of persons repeatedly thereby creating trust gaps between collector and taxpayer.

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