CHAPTER 5

SALARY INCOME

The first head of income in every paper. Tested through **receipt basis**, **perquisite valuation (s.13)**, **retirement benefits**, the **employee share scheme** and the **employer-borne tax gross-up**. Law: ITO 2001 · **tax year 2027**.

CHAPTER ROADMAP

1. **Salary & basis of charge** — s.12
2. **Perquisites** — s.13
3. **Retirement & exempt benefits** — cl.13 · 19 · 53A
4. **Employee share scheme** — s.14
5. **Special reliefs & withholding** — s.12(3) · 149

DEFINITION

Salary [s.12(2)] is any amount **received** by an employee from **employment**, whether of revenue or capital nature — pay, bonus, allowances, perquisites, profits in lieu of salary, pension, employee-share-scheme gain and **tax borne by the employer**.

1 WHAT IS TAXED, AND WHEN

receipt basis · s.12

1 RECEIPT BASIS · s.12(1), s.69

Taxed in the year it is **received**, applied on your behalf, or made available. The month it was **earned** does not matter.

2 SALARY INCLUDES · s.12(2)

Pay, overtime, bonus, commission, leave pay, gratuity, perquisites, allowances, pension, ESS gain, termination and joining payments, **employer-borne tax**.

3 ALLOWANCES

Taxable, unless **solely spent on duty**. A **fixed monthly** or %-of-salary allowance, or one not actually spent, is always salary.

4 REIMBURSEMENTS

Taxable unless incurred **solely in performing duties** (e.g. actual hotel bill on an official tour).

5 DEEMED RECEIVED · s.12(5)

Paid by the employer, its **associate**, a third party under an arrangement, a **past or prospective employer**, or to the employee's associate/third party at his request.

6 NO DEDUCTIONS · s.12(4)

Costs of earning salary — travel to office, lease rentals of own car — are **never deductible**.

7 PAKISTAN SOURCE

Salary for employment **exercised in Pakistan**, wherever received. A **Pakistan Government** employee posted abroad is still taxed in Pakistan.

8 SALARIED RATES

Salaried slabs apply only when salary is **more than 75%** of taxable income; otherwise non-salaried rates.

EXAMPLE · WHICH TAX YEAR DOES JUNE SALARY FALL IN?

salary is credited on the 7th of the next month

June 2026 salary	→	paid 7 July 2026	→	TAX YEAR 2027
June 2027 salary	→	paid 7 July 2027	→	TAX YEAR 2028

2 SALARIED INDIVIDUAL SLABS

tax year 2027 · salary taxed under the normal regime

Taxable income (Rs.)	Tax
Up to 600,000	Nil
600,001 – 1,200,000	1% of the excess over 600,000
1,200,001 – 2,200,000	6,000 + 11% of the excess over 1,200,000
2,200,001 – 3,200,000	116,000 + 20% of the excess over 2,200,000
3,200,001 – 4,100,000	316,000 + 25% of the excess over 3,200,000
4,100,001 – 5,600,000	541,000 + 29% of the excess over 4,100,000
5,600,001 – 7,000,000	976,000 + 32% of the excess over 5,600,000
Above 7,000,000	1,424,000 + 35% of the excess over 7,000,000

EXAMPLE

Salary of Rs. 2,845,000 → 116,000 + 20% × (2,845,000 − 2,200,000) = **Rs. 245,000**. Always locate the slab first, then apply fixed amount + rate on the **excess** only.

3 PERQUISITES · VALUATION RULES

section 13 · FMV less what the employee pays

A **perquisite** is a benefit in cash or in kind given because of the job. Each type has its own valuation rule — learn the **base** used, not just the percentage.

Perquisite	Section	Amount included in salary	Common trap
Motor vehicle	13(3) · Rule 5	**Official use only** – nil. **Partly personal:** owned 5% of **cost to employer**; leased 5% of **FMV at start of lease**. **Personal only:** 10% on the same bases.	Lease rentals and today's market value are irrelevant
Accommodation	13(12) · Rule 4	**Higher of** (a) rent employer would pay / actually pays and (b) **45% of minimum of time scale** (basic salary if no scale). Where HRA is admissible at 30%: not less than 30% of MTS.	Use **MTS**, not the actual basic
Utilities	13(6)	**FMV** of electricity, gas, water, telephone **less** payment by the employee.	Telephone is a utility
Domestic servants	13(5)	**Total salary** paid to housekeeper, gardener, driver etc. **less** payment by the employee.	Deduct the employee's payment
Interest-free / concessional loan	13(7), (8)	**(10% benchmark − rate charged)** × loan × months ÷ 12. **Loans up to Rs. 1,000,000: nil.**	Threshold is a loan size, not interest
Waiver of obligation	13(9)	The **amount waived** (e.g. staff advance written off).	Taxed even though no cash moves
Employer pays employee's obligation	13(10)	The **amount repaid** to the third party.	Instalments paid to a bank for him
Transfer of property / services	13(11)	**FMV at the time of transfer less** price paid by the employee.	**Book value** is a trap
Any other perquisite	13(13)	**FMV less** payment by the employee.	–

4 WORKED EXAMPLES

fresh numbers · tax year 2027

ACCOMMODATION · RULE 4

MTS Rs. 160,000 a month; company pays rent Rs. 75,000 a month.
(a) Rent = 75,000 × 12 = **900,000**
(b) 45% × 160,000 × 12 = **864,000**
Higher → **Rs. 900,000** added to salary.

CONCESSIONAL LOAN · s.13(7)

Rs. 2,400,000 loan from 1 Jan 2027 at 5% (6 months in the tax year).
(10% − 5%) × 2,400,000 × 6/12
= **Rs. 60,000** added to salary.
A loan of Rs. 900,000 would add **nil**.

TRANSFER OF CAR · s.13(11)

Car sold to employee for Rs. 1,800,000; FMV on that day Rs. 2,300,000; book value Rs. 1,500,000.
FMV 2,300,000 − paid 1,800,000
= **Rs. 500,000**. Book value ignored.

KEY POINT A house given **rent-free** to an employee gives the employer **no rental income** — the benefit is taxed only in the employee's hands under **Salary** [s.15 · Rule 4].

REMEMBER If the employer **pays the bill** or the **salary of staff** and the employee reimburses part, tax only the **net** amount. If the employee pays nothing, tax the full cost.

LOAN USE If the loan is used to buy an asset that earns **taxable income**, interest at the **benchmark rate** (or the actual rate if higher) is **deductible against that income** [s.13(8)] — e.g. an interest-free loan of Rs. 1,000,000 buys a generator rented out: no addition to salary, but a deduction of 10% is allowed.

5 VALUATION AT A GLANCE

pick the base

VEHICLE

Official 0% · mixed **5%** · personal **10%**
Owned: cost · Leased: FMV at lease start

HOUSE

Higher of rent and **45% × MTS**
(30% floor where HRA is 30%)

LOAN

(**10%** − rate paid) × loan × months/12
Up to **Rs. 1m**: nil

SERVICES & PROPERTY

Utilities / servants: **cost less recovery**
Property: **FMV less price**

6 GRATUITY

clause 13, Part I, Second Schedule

Type of gratuity	Tax treatment
Government employees	**Fully exempt**
Fund approved by the Commissioner	**Fully exempt**
Scheme approved by the Board	Exempt up to **Rs. 300,000**
Unapproved scheme / fund	Exempt up to the **lower of Rs. 75,000 or 50%** of the amount

UNAPPROVED GRATUITY: NO EXEMPTION IF

- Not received in **Pakistan**
- Received by a director who is **not a regular employee**
- Received by a **non-resident**
- Employee has **already received** gratuity (same or other employer)

7 PROVIDENT FUND

three kinds · salary for PF = basic + dearness allowance only

Event	Government PF	Recognised PF	Unrecognised PF
Employee's contribution	No treatment	No treatment	No treatment
Employer's contribution	**Exempt**	Exempt up to **lower of Rs. 150,000 or 1/10** of (basic + DA)	No treatment
Interest credited in the year	**Exempt**	Exempt up to **lower of 16% of the balance or 1/3** of (basic + DA)	No treatment
Payment of accumulated balance	**Exempt**	**Exempt**	**Employer's contribution and interest taxable** in year of receipt

8 PENSION

Finance Act, 2025 · exemption withdrawn

UP TO RS. 10 MILLION
0% under the final tax regime

ABOVE RS. 10 MILLION (AGE < 70)
5% on the amount exceeding Rs. 10 million · withheld by payer

RECIPIENT OVER 70
Fully exempt

STILL WORKING FOR THE FORMER EMPLOYER OR ITS ASSOCIATE
Taxed at normal **slab rates** (salaried / non-salaried as applicable)

9 OTHER EXEMPTIONS & EXCLUSIONS

know the clause

1 FOOD · EDUCATION · TREATMENT · cl.53A
Free or subsidised **food by hotels/restaurants** to their staff on duty; **education by a school** to staff children; **treatment by a hospital/clinic** to its staff.

2 MEDICAL · cl.139
Facility or reimbursement per terms of employment is exempt (hospital NTN, bills attested). **Medical allowance exempt up to 10% of basic** — fully taxable if a free medical facility is also provided, used or not.

3 LEAVE ENCASHMENT · cl.19
Exempt (preparatory to retirement) **only for government employees and Armed Forces**. Private sector: taxable.

4 WPPF · cl.26 · PENSION COMMUTATION · cl.12
WPPF received **as a worker**: fully exempt. Commutation of pension from Government or a **Board-approved** scheme: fully exempt.

5 BENEVOLENT GRANT · cl.24
Grant from the Central Employees Benevolent Fund (Act, 1969): **exempt**.

6 SCHOLARSHIP · s.47
Exempt **unless paid by an associate** of the student/employee.

7 NO LONGER AVAILABLE
The **senior citizen reduction** and the **full-time teacher / researcher** allowance are not available.

8 DUTY-RELATED REIMBURSEMENT
Actual official telephone / travel reimbursement: no tax **to the extent used officially**; private use is a taxable benefit.

10 SALARY EARNED ABROAD

three different sections

s.51(2) · LEFT PAKISTAN
A **citizen** who leaves during the year and stays abroad for the rest of it: salary earned abroad in that period is **exempt** — **salary only**; other income stays taxable.

s.102 · RESIDENT'S FOREIGN SALARY
Exempt **only if foreign income tax was paid** on it (withheld or paid directly). No foreign tax paid or payable → **taxable**.

s.101 · PAKISTAN GOVERNMENT EMPLOYEE
Salary is **Pakistan-source** even when the employment is exercised abroad.

11 SPECIAL COMPUTATIONS

three relief / gross-up rules

TAX BORNE BY EMPLOYER · 12(3)

Tax-free salary [s.12(3)]: tax borne by the employer is added to salary.

Formula: [fixed tax + rate × (salary − slab start)] ÷ **(1 − rate)**

Salary 2,500,000 → [116,000 + 20% × 300,000] ÷ 0.80 = **220,000**. Taxable salary = **2,720,000**.

GOLDEN HANDSHAKE · 12(6)

Termination compensation [s.12(6)]: elect to tax it at the **average rate**.

Rate = tax of 3 preceding years ÷ income of 3 years × 100

Tax Rs. 240,000 on income Rs. 4,800,000 → **5%**. On a Rs. 1,000,000 handshake = **Rs. 50,000**. Elect by the **return due date**.

ARREARS · 12(7)–(8)

Arrears of salary [s.12(7), (8)]: if the receipt pushes you into a higher rate, elect the **rates of the year in which it was earned**.

Notice to the Commissioner by the **due date of the return of the year of receipt** (or later date allowed).

Salary is still taxed in the year of **receipt**.

12 EMPLOYEE SHARE SCHEME

section 14

GRANT OF OPTION
No tax — a mere grant gives no benefit

›

ISSUE OF SHARES
FMV − option price − share price = salary

›

RESTRICTED SHARES
Tax at the **earlier** of free right to transfer or disposal

›

SALE OF THE OPTION
Proceeds − cost of option = **salary** (not capital gain)

COST OF SHARES **Cost of shares** (for capital gain on a later sale) = price paid for shares + price paid for option + **amount already taxed as salary**. Gain on sale = sale proceeds − this cost.

13 WITHHOLDING ON SALARY & RELATED PAYMENTS

section 149

Payment	Withholding / rule
Salary	**Average rate** on estimated annual salary, after other-head withholding and credits (ss.61, 63); s.60D education allowance is **ignored** by the employer; adjustable
Director's / board-meeting fee	**20% of the gross** amount, instead of the average rate · adjustable
Pension above Rs. 10 million (age below 70)	**5%** on the amount above Rs. 10 million
Advance tax (s.147)	A salaried individual is **not required** to pay advance tax
Excess deduction of the previous year	Employer may adjust it only if it was **from salary** and has not been refunded

14 EXAM FOCUS · MCQ TRAPS

what examiners test

1 Receipt, not accrual
June salary paid in July belongs to the **next** tax year.

2 Fixed means taxable
A fixed monthly allowance is salary even if the employee spends it on duty.

3 MTS, not actual basic
45% applies to the **minimum of the time scale**; rent paid is compared with it.

4 Lease: FMV at start
Leased car 5% uses FMV at the **commencement** of lease — not rentals, not today's value.

5 Book value is a trap
Transfers to employees use **FMV less price paid**.

6 Loan limit
Loans up to Rs. 1 million: **nil**. Above: (10% − rate) × loan × months/12.

7 Gratuity exemption lost
Abroad, non-resident, director not an employee, or a **second gratuity** → no exemption.

8 Gross-up divides
Employer-borne tax = ÷ **(1 − rate)**; then **check the slab** of the grossed-up salary.

9 Medical allowance cap
Exempt up to **10% of basic** — and only when **no free medical facility** is also provided.

10 Option sold ≠ capital gain
Proceeds of selling an ESS option less its cost are taxed as **salary**.

CLASSIFY IT · TAXABLE OR EXEMPT?

1	Fixed monthly conveyance allowance	TAXABLE
2	Actual hotel bill reimbursed on an official tour	NOT SALARY
3	Gratuity from a Commissioner-approved fund	EXEMPT
4	Leave encashment of a private-sector employee	TAXABLE
5	WPPF received as a worker	EXEMPT
6	Medical allowance where free hospitalisation is also given	TAXABLE
7	Unapproved gratuity received abroad	TAXABLE
8	Employer's PF contribution within the Rs. 150,000 / 1/10 limit	EXEMPT

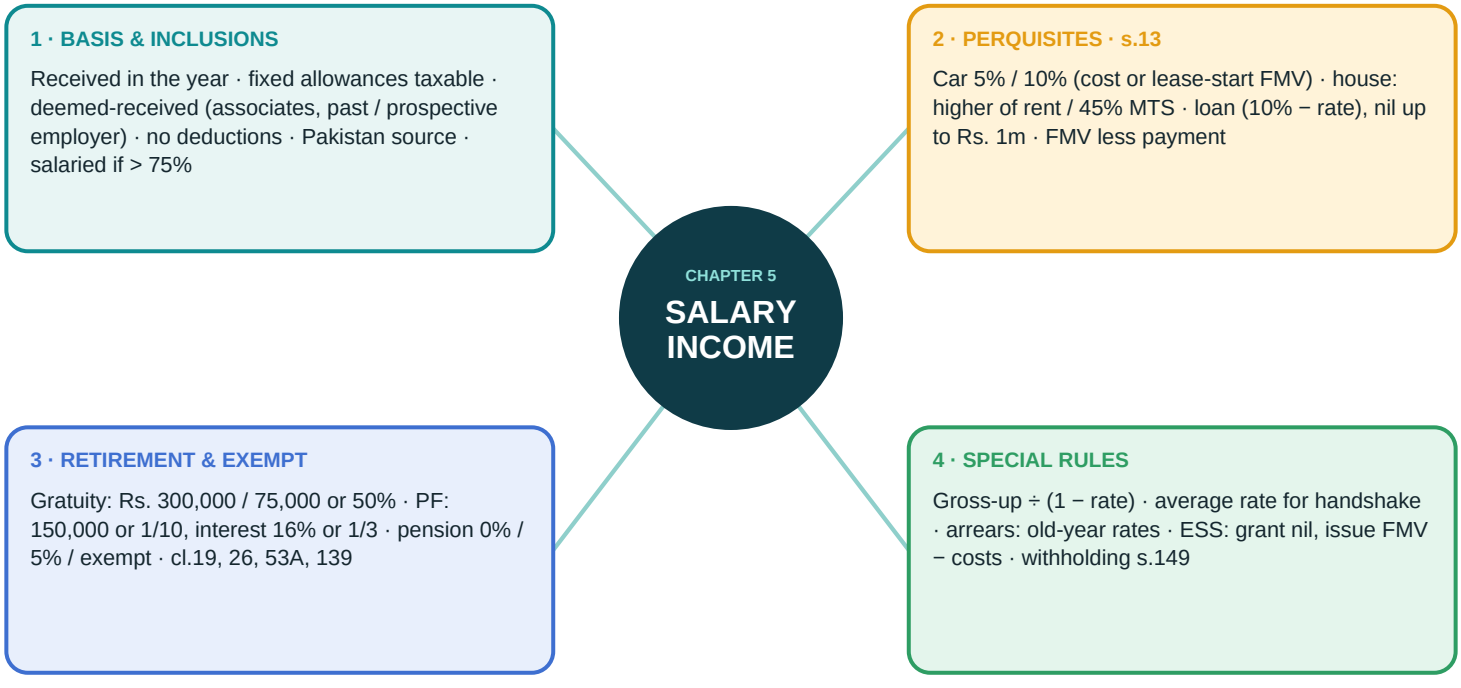
CLASSIFY IT · HOW IS IT VALUED?

1	Owned car used partly for private purposes	5% of cost
2	Car provided for personal use only	10% of cost
3	Leased car, mixed use	5% of FMV at lease start
4	Rent-free house	Higher of rent / 45% MTS
5	Interest-free loan of Rs. 900,000	Nil
6	Employer waives a staff advance	Amount waived
7	Employer pays staff electricity bill, employee pays part	FMV less payment
8	Car transferred to employee below market price	FMV less price paid

ONE LINE EACH

Salary	Perquisite	Loan	Tax borne by employer	Handshake
received in the year	FMV less payment	(10% − rate) × loan × months/12	tax ÷ (1 − rate)	average rate of 3 years

REVISION MAP



Receipt basis
Taxed when received, not when earned.

Perquisites
Know the base: cost, FMV, rent or MTS.

Exempt items
Clause numbers and limits decide.

Reliefs
Gross-up, average rate, arrears election.