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INCOME FROM SALARY

Presentation Agenda

- BASICS - SECTION 12 TO 14
- INCOME TAX RULES – VALUTAION OF PERQUISITES – ACCOMODATION, CONVEYANCE,
- SPECIFIC EXEMPTION PROVISIONS - SECTION 43, 44, 45, 50, 51
- DEDUCTIBLE ALLOWANCES – SECTION 60 TO 60b
- EXEMPTIONS IN SECOND SCHEDULE
- 2ND SCHEDULE PART I, CLAUSE 5, 8, 9, 12, 13, 22, 23, 23A, (SIXTH SCHEDULE & INCOME TAX RULE 91 TO RULE 121), 39,53A, 139
- 2ND SCHEDULE PART II, CLAUSE - NONE
- 2ND SCHEDULE PART III, CLAUSE - 2
- 2ND SCHEDULE PART IV, CLAUSE - NONE
- RATES OF TAX FIRST SCHEDULE
- TAX CREDITS SECTION 4, SECTION 61 TO 64, SECOND SCHEDULE PART I CLAUSE 61
- FOREIGN SOURCE SALARY SECTION 102
- ANTI AVOIDANCE SECTION 110
- GEOGRAPHICAL SOURCE OF INCOME SECTION 101
- TAX WITHHOLDING – SECTION 149

DEFINITION OF SALARY-Law

- **12. Salary.—** (1) Any salary received by an employee in a tax year, other than salary that is exempt from tax under this Ordinance, shall be chargeable to tax in that year under the head “Salary”.
- (c) the amount of any allowance provided by an employer to an employee including a cost of living, subsistence, rent, utilities, education, entertainment or travel allowance, but shall not include any allowance solely expended in the performance of the employee’s duties of employment;
- (d) the amount of any expenditure incurred by an employee that is paid or reimbursed by the employer, other than expenditure incurred on behalf of the employer in the performance of the employee’s duties of employment;

DEFINITION OF SALARY-Comments

- **COMPUTATION OF TAXABLE SALARY**

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- The word salary has been defined in the Income Tax Ordinance, 2001 to include almost every benefit from the employer. (section 12)

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- Some benefits are treated directly as part of salary for example bonus of Rs.25,000 would be directly included in the salary however there are other benefits whose taxation is a bit tricky and such tricky treatments are expected to be exam focal points.

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- The computation of salary involves identification of benefits that are **taxable** and those which are **exempt** and then the net amount is reduced by available **deductions**.

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- Exam focal points with respect to taxable benefits, exempt benefits and deductions are discussed hereunder:

DEFINITION OF SALARY CONT.. - Law

- (e) the amount of any profits in lieu of, or in addition to, salary or wages, including any amount received —
 - (i) as consideration for a person's agreement to enter into an employment relationship;
 - (ii) as consideration for an employee's agreement to any conditions of employment or any changes to the employee's conditions of employment;
 - (iii) on termination of employment, whether paid voluntarily or under an agreement, including any compensation for redundancy or loss of employment and golden handshake payments;
 - (iv) from a provident or other fund, to the extent to which the amount is not a repayment of contributions made by the employee to the fund in respect of which the employee was not entitled to a deduction; and
 - (v) as consideration for an employee's agreement to a restrictive covenant in respect of any past, present or prospective employment;

Termination Benefits-Law

- (6) An employee who has received an amount referred to in sub-clause (iii) of clause (e) of sub-section (2) in a tax year may, by notice in writing to the Commissioner, elect for the amount to be taxed at the rate computed in accordance with the following formula, namely: —
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 - **A/B%**
 - where —
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 - **A** is the total tax paid or payable by the employee on the employee's total taxable income for the three preceding tax years; and
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 - **B** is the employee's total taxable income for the three preceding tax years.

Arrears of Salary-Law

- (7) Where —
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 - (a) any amount chargeable under the head “Salary” is paid to an employee in arrears; and
 -
 - (b) as a result the employee is chargeable at higher rates of tax than would have been applicable if the amount had been paid to the employee in the tax year in which the services were rendered,
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 - the employee may, by notice in writing to the Commissioner, elect for the amount to be taxed at the rates of tax that would have been applicable if the salary had been paid to the employee in the tax year in which the services were rendered.
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 - (8) An election under sub-section (6) or (7) shall be made by the due date for furnishing the employee’s return of income or employer certificate, as the case may be, for the tax year in which the amount was received or by such later date as the Commissioner may allow.

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Comments-Termination Benefits

- **Arrears of salary**
- **Section 12(7)** Any **arrears of salary** paid by employer to employee and as a result employee is chargeable to higher rates of tax, the employee can **elect** to have such arrears taxed at the rates that would have been applicable had the salary been paid to employee in the tax year in which the services were rendered. For example Govt of Pakistan inducted many employees in Govt organizations who were terminated by previous Govts on the grounds that these were political appointments. As a result of re-induction, Govt is also paying them arrears for the previous years and some may get arrears of around 10 years. Since such arrears may render income of these employees in a much higher tax slab so these employees may opt to have these arrears taxed in the previous years under section 12(7) and resultantly may not even have to pay a penny. For example a person is paid in 2012 by Govt salary arrears of Rs.500,000 constituting annual salary of Rs.50,000 for each of last ten years. For tax year 2012 total arrears would fall in 3.5% slab rate however if taxed separately for each year no tax liability would arise as Rs.50,000 was exempt for tax in all the previous ten years.

Comments-Arrears

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Valuation of Vehicle

- (3) Where, in a tax year, a motor vehicle is provided by an employer to an employee wholly or partly for the private use of the employee, the amount chargeable to tax to the employee under the head “Salary” for that year shall include an amount computed as may be prescribed.

	Provided for official use only	Provided for personal use	Provided partly for personal partly for official us
	Amount to be included in taxable salary		
In case of vehicle purchased by employer	None	10% of cost of vehicle	5% of cost of vehicle
In case of leased vehicle by employer	None	10% of Fair market value at the commencement of lease	5% of Fair market value at the commencement of lease

Loan From Employer

- **Section 13(7) & (8) Loan by employer to employee** – In case of interest free loan or loan at a rate lower than benchmark rate (10% for tax year 2013), no interest or less interest is a benefit by employer to employee and is deemed as salary income if loan amount is in excess of **Rs.1,000,000**.
- The said benefit of interest is not deemed to arise and not included in salary if such benefit arises to an employee due to waiver of interest by such employee on his account with the employer.
- If the loan is utilized for purchase of income generating asset, the deemed interest benefit can be claimed as deemed expense in proportion to the loan utilized for purchase of income generating asset.

Accommodation

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- **Section 13(12) Value of accommodation:**
- - Higher of the following
- the amount that would have been paid by employer if no accommodation was provided
- 45% of MTS or basic salary
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- Where house rent allowance is admissible @ 30%, value of accommodation is higher of:
- the amount that would have been paid by employer if no accommodation was provided
- 30% of MTS or basic salary
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-Employee Share Option Scheme

- **14. Employee share schemes.**— (1) The value of a right or option to acquire shares under an employee share scheme granted to an employee shall not be chargeable to tax.
- (2) Subject to sub-section (3), where, in a tax year, an employee is issued with shares under an employee share scheme including as a result of the exercise of an option or right to acquire the shares, the amount chargeable to tax to the employee under the head “Salary” for that year shall include the fair market value of the shares determined at the date of issue, as reduced by any consideration given by the employee for the shares including any amount given as consideration for the grant of a right or option to acquire the shares.
- (3) Where shares issued to an employee under an employee share scheme are subject to a restriction on the transfer of the shares —
 - (a) no amount shall be chargeable to tax to the employee under the head “Salary” until the earlier of —
 - (i) the time the employee has a free right to transfer the shares; or
 - (ii) the time the employee disposes of the shares; and
 - (b) the amount chargeable to tax to the employee shall be the fair market value of the shares at the time the employee has a free right to transfer the shares or disposes of the shares, as the case may be, as reduced by any consideration given by the employee for the shares including any amount given as consideration for the grant of a right or option to acquire the shares.
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-Employee Share Option Scheme

- (4) For purposes of this Ordinance, where sub-section (2) or (3) applies, the cost of the shares to the employee shall be the sum of —
 - (a) the consideration, if any, given by the employee for the shares;
 - (b) the consideration, if any, given by the employee for the grant of any right or option to acquire the shares; and
 - (c) the amount chargeable to tax under the head “Salary” under those sub-sections.
- (5) Where, in a tax year, an employee disposes of a right or option to acquire shares under an employee share scheme, the amount chargeable to tax to the employee under the head “Salary” for that year shall include the amount of any gain made on the disposal computed in accordance with the following formula, namely:—
 - **A—B** where —
 - **A** is the consideration received for the disposal of the right or option; and
 - **B** is the employee’s cost in respect of the right or option.
 - (6) In this sub-section, “employee share scheme” means any agreement or arrangement under which a company may issue shares in the company to —
 - (a) an employee of the company or an employee of an associated company; or
 - (b) the trustee of a trust and under the trust deed the trustee may transfer the shares to an employee of the company or an employee of an associated company.

-Employee Share Option Scheme

- **Section 14 Employee Share option Scheme:**
 - Value of right to acquire shares is NOT to be included in salary however if right sold then difference between consideration received for sale of right and amount paid to acquire right to be included in salary
 - Fair market value of shares acquired under the scheme is to be included in salary at the earlier of the following dates:
 - Date of issue; or
 - In case of restriction on transfer of shares, date when employee has free right to transfer
 - Shares acquired under the scheme if sold, capital gain or loss to be calculated as per provisions of section 37 or 37A whichever is applicable
 - Capital Gain to be calculated as difference between consideration received and cost of share where cost of share acquired under employee share scheme includes:
 - Cost paid to acquire right under the scheme
 - Cost paid to acquire shares under the scheme
 - Amount already charged to tax under salary in respect of such shares. Please note that for computation of cost of shares the amount charged to tax under the head salary does not include amount charged to tax as salary on disposal of right. Please see my numerical separately provided for explanation of this scheme.

ESOS - Example

Q		<p>On July 01, 2014 Rehman (Private) Limited announced employee share option scheme for its employees. The value of right under the scheme was Rs.5 per share. The employees were offered shares at a price of Rs.10 per share while the fair market value of shares was Rs.25 at that time however the transfer of shares was restricted till September 30, 2014 when the fair market value was Rs.20 per share.</p>
		<p>Mr. Shahbaz, an employee of the company, purchased right to acquire 100,000 shares in the company. Mr. Shahbaz sold the right for 50% shares at Rs. 15 per shares and acquired the remaining shares.</p>
	a	<p>Compute the amount to be included in Salary income of Mr. Shahbaz for the tax year 2012.</p>
	b	<p>Compute gain/ loss to Mr. Shahbaz when Mr. Shahbaz transferred his shares to Mr. Shah on December 31, 2014 when fair market value of shares was Rs. 22 per share.</p>

Self Hiring

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- **Self occupied house given on rent to employer:** Where an employer provides house rent to its employee for the house owned by employee the amount so paid would have two tax implications. Such amount would be included in the salary of employee and also taxable as income from property. Usually students find this treatment difficult to comprehend and my past experience suggests it can only be explained in class or meeting. So those who do not understand this, please contact and visit my office. Note that this is a settled issue at appellate level.

Foreign Source Salary

- **Section 102 Foreign Source Salary** of resident individuals is exempt from tax if foreign income tax paid.

Special Allowance

- **Section 12(2)(c)** Allowance solely expended in the performance of employee's duties of employment. **Clause 39 (Part I) Second Schedule** also provides similar exemption i.e. a special allowance or benefit (not being entertainment or conveyance allowance) granted to meet wholly and necessarily incurred in the performance of the duties of an office. Examples are T.A.D.A., Relocation allowance. Some may ask whether travelling allowance (included in T.A.D.A.) will be allowed as conveyance allowance is specifically disallowed under clause 39. In my opinion, conveyance allowance mentioned in clause 39 refers to regular conveyance allowance paid usually as part regular salary while travelling allowance meant to meet travelling expense (usually coupled with daily allowance) when an employee is sent for some official trip (for example employee sent to Lahore for official duty) is exempt.

Medical

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- **Clause 139 of Part I of Second Schedule Free Medical facility** exempt if provided in accordance with the terms of employment.
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- **Clause 139 of Part I of Second Schedule Medical allowance** exempt up to 10% of basic salary **IF** no free medical facility available under the terms of employment. Please note that even if no payment is made to employee on account of free medical facility but such facility is available in the terms of employment then **MEDICAL ALLOWANCE WILL NOT BE EXEMPTED.**

Pension

- **Clause 8 & 9 of Part I of Second Schedule Pension** exempt however exemption is not available in following cases:
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 - Employee continues to work for the same employer or employer's associate;
 - in case of two pensions only one pension is exempt
 - However if any employee receives two pensions but one is from Federal, Provincial or Armed Forces of Pakistan and one from a private employer, both the pensions are exempt.

Gratuity & Commutaion of Pension

- Fully Exempt if paid by Govt or fund approved by Commissioner
 - Exempt up to Rs.300,000 if paid by a scheme approved by Federal board of Revenue
 - Exempt up to lesser of Rs.75,000 or 50% of the amount received in any other case however even this minor exemption to such unrecognized funds/ schemes is not available in any of the following cases:
 - Payment not received in Pakistan;
 - Payment received by a director who is not regular employee of the company;
 - Payment received by employee who is non-resident; or
 - Gratuity received by an employee who has already received gratuity from the same or any other employer

Provident Fund

Particulars	Government Fund	Recognized Fund	Unrecognized Fund
Employee contribution	Already taxed as part of salary	Already taxed as part of salary	Already taxed as part of salary
Employer contribution	No treatment at the time of transfer of amount to Provident fund balance	Exempt up to 10% of salary or Rs.150,000 per annum whichever is less	No treatment at the time of transfer of amount to Provident fund balance
Interest	No treatment at the time of transfer of amount to Provident fund balance	Exempt up to 1/3 rd of salary or provided @ 16% whichever is less	No treatment at the time of transfer of amount to Provident fund balance
Accumulated Balance	Exempt	Exempt	Fully taxable except employee contribution

Note: Salary includes basic salary and dearness allowance only

Subsidized benefits

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- **Clause 53A- Part I of Second Schedule** – ~~free or concessional travel by transporters to their employees (families also),~~ free or subsidized food by hotels & restaurants by employees during duty hours, free or subsidized education by educational institution to employee's children, free or subsidized medical treatment by hospitals to their employees. (the struck through facility has been deleted by Finance Act 2013-14).

Foreign Govt. Officials-Sec 43

- **43. Foreign government officials.**— Any salary received by an employee of a foreign government as remuneration for services rendered to such government shall be exempt from tax under this Ordinance provided —
 - (a) the employee is a citizen of the foreign country and not a citizen of Pakistan;
 - (b) the services performed by the employee are of a character similar to those performed by employees of the Federal Government in foreign countries; [and]
 - (c) the foreign government grants a similar exemption to employees of the Federal Government performing similar services in such foreign country[.]

Exemptions under Int. Agreements

- **44. Exemptions under international agreements.—**
- (1) Any Pakistan-source income which Pakistan is not permitted to tax under a tax treaty shall be exempt from tax under this Ordinance.
- (2) Any salary received by an individual (not being a citizen of Pakistan) shall be exempt from tax under this Ordinance to the extent provided for in an Aid Agreement between the Federal Government and a foreign government or public international organization, where:
 - (a) the individual is either [not a resident] individual or a resident individual solely by reason of the performance of services under the Aid Agreement;
 - (b) if the Aid Agreement is with a foreign country, the individual is a citizen of that country; and
 - (c) the salary is paid by the foreign government or public international organisation out of funds or grants released as aid to Pakistan in pursuance of such Agreement.
- (3) Any income received by a person (not being a citizen of Pakistan) engaged as a contractor, consultant, or expert on a project in Pakistan shall be exempt from tax under this Ordinance to the extent provided for in a bilateral or multilateral technical assistance agreement between the Federal Government and a foreign government or public international organisation, where —
 - (a) the project is financed out of grant funds in accordance with the agreement;
 - (b) the person is either a non-resident person or a resident person solely by reason of the performance of services under the agreement; and
 - (c) the income is paid out of the funds of the grant in pursuance of the agreement.

FSI of Short term resident

- **50. Foreign-source income of short-term resident individuals.**— (1) Subject to sub-section (2), the foreign-source income of an individual [] —
 - (a) who is a resident individual solely by reason of the individual's employment; and
 - (b) who is present in Pakistan for a period or periods not exceeding three years,
- shall be exempt from tax under this Ordinance.
- (2) This section shall not apply to —
 - (a) any income derived from a business of the person established in Pakistan; or
 - (b) any foreign-source income brought into or received in Pakistan by the person

Expatriates

- **51. Foreign-source income of returning expatriates.—**
- [(1)] Any foreign-source income derived by a citizen of Pakistan in a tax year who was not a resident individual in any of the four tax years preceding the tax year in which the individual became a resident shall be exempt from tax under this Ordinance in the tax year in which the individual became a resident individual and in the following tax year.
- [(2) Where a citizen of Pakistan leaves Pakistan during a tax year and remains abroad during that tax year, any income chargeable under the head “Salary” earned by him outside Pakistan during that year shall be exempt from tax under this Ordinance.]

DEDUCTIONS FROM SALARY

- **DEDUCTIONS**
- **Zakat** paid under Zakat & Ushr Ordinance is allowed as deduction.
- Amount paid as donation to charitable institutions listed under clause 61 of Part I of second schedule is also allowed as a deduction from taxable salary up to 30% of taxable income of individuals.
- Usually donations to President or Prime Minister's relief funds are allowed as deduction straight deduction from salary.

DEDUCTIONS FROM SALARY

- **Profit on Debt**
- Loan taken for construction of house or acquisition of house
- Previously tax credit was allowed now deduction allowed
- Profit on debt paid in a tax year to bank, NBFC regulated by SECP, Federal Govt, Prov Govt. Local Govt, listed company
- Deduction allowed up to lower of:
 - 50% of taxable income or
 - Rs.2,000,000.

DEDUCTIONS FROM SALARY

- **Education expenses of Children**
- Available to individual having taxable income of less than Rs. 1,500,000 (salary or otherwise)
- Limited to;
 - Five percent of total tuition fee paid in the year
 - 25% of taxable income for the year
 - Rs.60,000*number of children
- Allowance not allowed to be c/ f to next year
- Allowed against income of either parent
- Adjustment not allowed to be made by employer

Reductions from tax liability

- [(1B) Where the taxable income in a tax year, other than income on which the deduction of tax is final, does not exceed one million rupees of a person-
- holding a National Database Registration Authority's Computerized National Identity Card for disabled persons; or
- a taxpayer of the age of not less than sixty years on the first day of that tax year, the tax liability on such income shall be reduced by 50%.]
- [(2) The tax payable by a full time teacher or a researcher, employed in a non profit education or research institution duly recognized by Higher Education Commission, a Board of Education or a University recognized by the Higher Education Commission, including government training and research institution, shall be reduced by an amount equal to [40]% of tax payable on his income from salary.]
- Foreign tax credit
- Tax credit for donations, investment in shares & insurance, interest on loan for house construction/ acquisition, investment in pension scheme
- Tax credit of tax already deducted/ collected paid under section 147 (advance tax) & section 168 (collected/ deducted tax)

TAX CREDITS

- Section 61-64 tax credits are calculated through a common formula

$$A / B * C$$

- A = tax assessed before allowance of any tax credit under Part X of Chapter III i.e. Tax liability less reduction in tax liability under second schedule (senior citizen, teacher) less foreign tax credit.
- B = Taxable income for the tax year
- C = Lower of the Actual amount, % of taxable income or a fixed amount in these sections

TAX CREDITS

	Charitable donation (61)	Investment in shares/ sukuk / life premium (62)	Contribution to voluntary pension scheme (63)	Health Insurance (62A)
Actual amount	Actual amount of donation (fair value of in kind donation) paid	Actual amount of investment or share premium paid whichever is applicable	Actual amount of contribution paid in the year	Actual contribution paid
% of taxable income	30% (20% for companies)	20%	20% (see note)	5%
Fixed amount	Not applicable	1,500,000	Not applicable	150,000

Person joining at the age of forty one years or above, till **June 30, 2019**, additional contribution of 2% per annum for each year of age exceeding forty years but maximum **30%** of last year's taxable income.

e.g.

1. Person joins scheme in tax year 2013 at the age of 50 years the contribution allowed is 40%. (20% + 10 yrs * 2% but capped at 30% of last year taxable income

Person joins in 2013 at the age of 58 yrs, allowed 50%. (20% + 18yrs * 2 = 56% but capped at 30% of last year taxable income)

TAX CREDITS – Other Conditions

- **Charitable Donations**
 - Paid to approved NPOs or Federal or provincial education inst or hospitals
 - Must be paid through normal banking channels-in kind fair value
- **Investment in shares or Insurance Premium - Either**
 - Not allowed for companies and non-residents
 - Investment in new listed shares as original allottee or shares acquired from Privatization Commission
 - Shares must not be disposed before expiry of 24 months from the date of acquisition otherwise the credit received will be added back to the income in the year in which the shares are disposed off
 - **Life insurance policy not surrendered in 2 years**
- **Insurance Premium**
 - Payment of life insurance premium only
 - Paid to life insurance company registered with SECP

TAX CREDITS-Other Conditions

- **Contribution to Approved Pension Fund**
 - Individuals only
 - Contribution only to approved funds under Voluntary Pension System Rules 2005
 - Eligible persons only as defined under said rules
- **Health Insurance**
- Allowed to individual against income from salary or income from business
- Paid to insurance company registered under Ins ord 2000
- Individual must be resident
- Individual must be filer

Geo-graphical source of income

- (1) Salary shall be Pakistan-source income to the extent to which the salary —
 -
 - (a) is received from any employment exercised in Pakistan, wherever paid; or
 -
 - (b) is paid by, or on behalf of, the Federal Government, a Provincial Government, or a [Local Government] in Pakistan, wherever the employment is exercised.

Anti Avoidance – Section 110

- Where, in any tax year, salary is paid by a private company to an employee of the company for services rendered by the employee in an earlier tax year and the salary has not been included in the employee's salary chargeable to tax in that earlier year, the Commissioner may, if there are reasonable grounds to believe that payment of the salary was deferred, include the amount in the employee's income under the head "Salary" in that earlier year.

Withholding Tax – section 149

(1) Every [person responsible for] paying salary to an employee shall, at the time of payment, deduct tax from the amount paid at the employee's average rate of tax computed at the rates specified in Division I of Part I of the First Schedule on the estimated income of the employee chargeable under the head "Salary" for the tax year in which the payment is made after making [adjustment of tax withheld from employee under other heads and tax credit admissible under section 61, 62, 63 and 64 during the tax year after obtaining documentary evidence], as may be necessary, for [:]

- (i) tax withheld from the employee under this Ordinance during the tax year;
- (ii) any excess deduction or deficiency arising out of any previous deduction; or
- (iii) failure to make deduction during the year;]

(2) The average rate of tax of an employee for a tax year for the purposes of sub-section (1) shall be computed in accordance with the following formula, namely:–
A/B where –

- **A** is the tax that would be payable if the amount referred to in component **B** of the formula were the employee's taxable income for that year; and
- **B** is the employee's estimated income under the head "Salary" for that year.

(3) Notwithstanding anything contained in sub-sections (1) and (2), every person responsible for making payment for directorship fee or fee for attending board meeting or such fee by whatever name called, shall at the time of payment, deduct tax at the rate of twenty percent of the gross amount payable.

(4) Tax deductible under sub-section (3) shall be adjustable.