Tax Exemptions Beyond Legislative Mandate

This research note addresses two connected questions: first, whether the Provincial Government can, while fixing the service conditions of Appellate Tribunal members under the Balochistan Industrial Relations Act, 2010, extend to them the tax exemption reserved by law for Judges of the Supreme Court and High Courts; and second, whether recovery of such wrongly exempted tax is permissible. The analysis concludes that exemptions under the Income Tax Ordinance, 2001 lie exclusively within the federal domain and cannot be conferred by provincial action. Any exemption extended without statutory authority is void ab initio, and the tax so escaped remains lawfully recoverable.

RESEARCH CENTER, HIGH COURT OF BALOCHISTAN

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COURT: **HON'BLE MR. JUSTICE MR. GUL HASSAN TARREN BHC**
SUBJECT: TAX LAW
DATE: 25TH AUGUST 2026
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Queries

Q. No. 1:- Whether the Provincial Government, while fixing the terms and conditions of Appellate Tribunal members the Balochistan Industrial Relations Act, 2010 (since repealed), could extend to them the tax exemption on salary (allowances) which is expressly reserved by Clause (55), Part I of the Second Schedule to the Income Tax Ordinance, 2001 for Judges of the Supreme Court and High Courts?

Q. No. 2:- Whether recovery of tax wrongly exempted by the Provincial Government from the salary/allowances of an Appellate Tribunal member is permissible in law?

In responses to the first query, it is submitted as under: -

Under the scheme of the ***Income Tax Ordinance, 2001***, the charge of income tax is structured around five distinct heads of income. Section 11 of the Ordinance provides that all income of a person shall, for purposes of computation of total income, be classified under one of the following heads:

1. ***Salary****;*
2. ***Income from Property****;*
3. ***Income from Business****;*
4. ***Capital Gains****; and*
5. ***Income from Other Sources****.*

Among these heads, the **Salary**, is governed by **Section 12 of the Ordinance.** The general rule is that the ***entire salary received by an employee is chargeable to tax***. This is made explicit in **Section 12(1):**

> ***"12. Salary. (1) any salary received by an employee in a tax year shall be chargeable to tax in that year under the head 'Salary'."***

The ambit of the term *salary* is then elaborated in **Section 12(2)**, which includes almost any financial benefit received from employment. A critical qualification is, however, introduced in **Section 12(2)(c)**. While allowances are ordinarily taxable, the legislature has introduced a specific carve-out in the following terms:

> ***"…but shall not include any allowance solely expended in the performance of the employee's duties of employment."***

This exclusion recognizes that where an allowance is not in the nature of additional remuneration but is compensatory, designed exclusively to reimburse expenditure necessarily incurred in the course of official functions, ceases to be "salary" within the meaning of the Ordinance, and is therefore not chargeable to tax. This statutory exemption also found reinforcement in **Clause (39) of Part I of the Second Schedule** (*Clause (37) omitted by the Finance Act, 2002.*) which provided exemption for: *"Any special allowance or benefit…specially granted to meet expenses wholly and necessarily incurred in the performance of the duties of an office or employment of profit."* This provision further confirms the legislative intent that compensatory allowances of this character are to be exempt from tax.

Specific Exemption for Judges Clause (55), Part I of the Second Schedule

While the general statutory framework of Section 12(2) (c) secures exemption for duty-related allowances in all employments, the legislature has codified a separate exemption in **Clause (55) & (56), Part I of the Second Schedule**. Unlike the general carve-out of Section 12(2)(c), which requires proof of actual expenditure in the performance of duties, these clauses create exemptions ***ex lege***.

General Power to Grant Exemptions Section 53

Section 53 of the Income Tax Ordinance, 2001 constitutes the central statutory provision governing the grant of exemptions and concessions under the tax regime. A careful reading demonstrates that its two principal limbs, subsections (1) and (2) serve distinct purposes within a single comprehensive framework.

Subsection (1) is declaratory and static in character. It stipulates that the incomes or classes of income, and the persons or classes of persons specified in the **Second Schedule**, shall either be exempt from tax, subject to reduced rates, enjoy reductions in liability, or stand exempted from particular provisions of the Ordinance—always "subject to any conditions and to the extent specified therein." In effect, this subsection affirms that the exemptions codified in the Second Schedule are to be treated as part of the statute itself, binding with the same force as provisions enacted in the body of the Ordinance.

Subsection (2), by contrast, is enabling and dynamic. It empowers the **Federal Government, or the Board with the approval of the Federal Minister-in-charge and the Economic Coordination Committee of the Cabinet,** to amend the Second Schedule by notification in the official Gazette. Through this controlled mechanism, the executive may add, omit, or vary clauses in the Schedule, but only in defined situations of urgency such as national security, natural disasters, food security emergencies, abnormal international commodity price fluctuations, or to implement bilateral and multilateral agreements. This ensures that exemptions can be adapted to exigent circumstances, yet only within the narrow and supervised scope laid down by Parliament.

Taken together, subsections (1) and (2) form an **exhaustive code**: no exemption may exist outside the four corners of the Second Schedule, whether directly enacted by Parliament (subsection (1)) or validly incorporated through delegated authority (subsection (2)).

The ***constitutional scheme*** of Pakistan reinforces this conclusion. Under the Fourth Schedule, ***Federal Legislative List, Entry 47***, matters relating to taxes on income (other than agricultural income) fall exclusively within the domain of the Federation. Article 77 of the Constitution further mandates that *"no tax shall be levied for the purposes of the Federation except by or under the authority of Act of Parliament."* These provisions make it manifest that the competence to impose, regulate, or exempt income tax vests solely in Parliament and, in limited situations, in the Federal Government acting under delegated authority through Section 53 of the Income Tax Ordinance, 2001. Provincial Governments, while competent to regulate service conditions of employees under provincial enactments, cannot trench upon the federal legislative field of taxation. Any such attempt, even if styled as fixation of "terms and conditions" of service, constitutes executive overreach and is void ab initio as being repugnant to the federal distribution of powers.

Under the ***Balochistan Industrial Relations Act, 2010***, the constitution of the Appellate Tribunal is governed by Section 55. Subsection (2) stipulates that no person may be appointed as a member of the Tribunal unless he is, or has been, or is qualified to be appointed as, a Judge of the High Court. Subsection (4) further authorizes the **Provincial Government** to determine the terms and conditions of service of such members. It is in exercise of this power that the Government has equated the salary of Tribunal members with that of serving High Court Judges.

However, the matter of **tax exemption** does not fall within the competence of the Provincial Government. The **Income Tax Ordinance, 2001** is a Federal statute, and **Section 53** thereof vests the exclusive authority to grant tax exemptions in the **Federal Government**, acting by notification in the Official Gazette and through incorporation in the Second Schedule. In the case of Judges of the superior judiciary, this exemption is specifically embodied in **Clause (55) of Part I of the Second Schedule**, thereby carrying the force of law.

Accordingly, while the Provincial Government may fix the remuneration of Tribunal members on par with High Court Judges under the Balochistan Industrial Relations Act, it had **no authority to extend to them the tax exemptions** which are available to Judges under Federal law. The exemption is a matter of statutory command, not administrative discretion, and cannot be implied or conferred by executive fiat at the provincial level.

The doctrine of ***ultra vires*** envisages that an authority can exercise only such powers as are conferred upon it by law. An act performed within the authority's legal limits is **intra vires**, whereas any action beyond those limits is **ultra vires**. In ***Messrs RAJBY Industries Karachi & others v. Federation of Pakistan & others*** **(2023 SCMR 1407)**, the petitioners challenged the proviso in **S.R.O. 491(I)/2016**, which disallowed input tax credit on packing material, as being ultra vires the Sales Tax Act, 1990. The Supreme Court held that doctrine of ultra vires envisages that an authority can exercise only so much power as is conferred on it by law---Any action of the authority is intra vires when it falls within the limits of the power conferred on it but ultra vires if it goes outside this limit---If an act entails legal authority and it is done with such authority, it is symbolized as intra vires (within the precincts of powers) but ***if it is carried out shorn of authority, it is ultra vires***.

It has long been settled in our jurisprudence that fiscal statutes must be interpreted with strictness and precision. In ***Zila Council Jehlum v. Pakistan Tobacco Company Ltd.*** **(PLD 2016 SC 398)**, a five-member Bench of the Hon'ble Supreme Court reiterated that ***charging sections in fiscal enactments are the key provisions imposing liability, and must be construed strictly; neither liability can be created nor exemption inferred except through clear statutory language.***

This principle was earlier affirmed in ***Province of Punjab v. Muhammad Aslam*** **(2004 SCMR 1649),** wherein it was categorically held that *taxing statutes are required to be construed strictly. There is no intendment or presumption about a tax.*

In a recent case, Honourable Supreme Court in ***Pakistan Telecommunication Employees Trust v. Federation of Pakistan*** **(PLD 2017 SC 718)** observed that ***mere creation by Government or functional similarity with exempted institutions does not attract exemption of taxes absent express statutory language***.

In ***Prime Commercial Bank Ltd. v. ITAT Lahore*** **(2015 PTD 2091),** employees of a private banking company sought to claim the benefit of Clause 3 of Part IV of the Second Schedule to the repealed Income Tax Ordinance, 1979. That clause exempted "perquisites, allowances or other benefits" provided by a *banking company or financial institution owned and controlled by the Federal Government*. The petitioners argued that the said clause extent to private banks and they avail the exemption. The Lahore High Court, however, rejected this claim. It held that ***the exemption was only for banks owned and controlled by the Federal Government***. Private banks, which emerged only later through privatization, were never intended to be beneficiaries. ***The Court reinforced that tax exemptions must be construed strictly, and the scope cannot be expanded by inference, analogy, or equitable considerations***.

In ***Muhammad Asif and others v. Federation of Pakistan*** **(2018 PTD 806),** the Peshawar High Court reaffirmed the principle that ***income chargeable to tax can only be exempted where it falls strictly within the scope of entries provided in the Second Schedule.*** This makes it manifest that fiscal exemptions derive exclusively from the Ordinance itself, and cannot be conferred by implication or by administrative determination.

Applied to the present context, these authorities admit of no doubt. The charge of income tax under Sections 11 and 12 of the Income Tax Ordinance, 2001 applies to all salary unless the legislature itself has carved out an exception in the Second Schedule. Clause (55) of Part I of the Schedule provides such exemption exclusively to the judicial allowance of Judges of the Supreme Court and High Courts. No other category of office-holders, even if remunerated at the same scale or enjoying analogous functions, is covered by this exemption.

The reliance placed by the Provincial Government on its power under Section 55 of the Balochistan Industrial Relations Act, 2010 (*since repealed*) to determine the "terms and conditions" of members of the Appellate Tribunal cannot override this statutory scheme. Fixing remuneration equal to that of a High Court Judge is within its competence; granting exemption from federal income tax is not. The Supreme Court's pronouncements in *PLD 2016 SC 398* and *2004 SCMR 1649* make it abundantly clear that fiscal exemptions cannot be conferred by implication, nor by administrative fiat of a subordinate authority, but only by express command of Parliament or by valid notification under Section 53 of the Ordinance.

It thus follows that the tax exemption available to Judges of the superior judiciary under Clause (55), Part I of the Second Schedule, being a matter of legislative mandate, cannot be extended by the Provincial Government to members of the Appellate Tribunal constituted under the Balochistan Industrial Relations Act, 2010. Any such attempt would fall foul of the settled rule that fiscal statutes brook no intendments, and that neither liability nor immunity can exist outside the four corners of the law.

<u>Query No. 2</u>

Whether recovery of tax wrongly exempted by the Provincial Government from the salary/allowances of an Appellate Tribunal member is permissible in law?

The matter admits of little doubt. Under the Income Tax Ordinance, 2001, the charge of income tax is mandatory and attaches to all taxable income unless a valid exemption is provided in the Second Schedule. Clause (55), Part I of the said Schedule reserves exemption only for Judges of the Supreme Court and High Courts. Any exemption purportedly granted to members of an Appellate Tribunal under the Balochistan Industrial Relations Act, 2012, being without lawful authority, is void ab initio.

The jurisprudence of the Superior Courts is settled that where no lawful exemption exists, recovery of the tax so escaped is not merely permissible but obligatory.

In **Chandi Prasad Uniyal v. State of Uttarakhand** (2013 SCMR 552), the Supreme Court of India articulated the principle in categorical terms: "Any amount paid/received without authority of law can always be recovered barring few exceptions of extreme hardships but not as a matter of right. In such situations law implies an obligation on the payee to repay the money, otherwise it would amount to unjust enrichment." (para 16).The Court further clarified: "Except few instances… the excess payment made due to wrong/irregular pay fixation can always be recovered." (para 17).

As to the manner of recovery, Section 137 read with Sections 111–113 of the Ordinance empowers the Department to assess and recover tax which has escaped assessment or been under-charged. The liability is personal to the taxpayer, even if the non-deduction or exemption was occasioned by an erroneous order of the Provincial Government.

In view of the above, it can be held that recovery of income tax wrongly exempted from the salary or allowances of an Appellate Tribunal member is permissible in law. Such exemption being void ab initio, the member is not absolved from liability under the Income Tax Ordinance, 2001.

The End