



PAKISTAN / EMPLOYMENT & TAX

Gratuity, explained.

What is owed. How it is calculated. What is taxed.

A practical guide with worked examples, official law references and the distinction between approved funds and approved schemes.

Reviewed 10 September 2026 • Federal tax + selected provincial provisions



START HERE

What is gratuity?

A lump-sum employment benefit. Work out the right to payment before working out its tax.

01 / ENTITLEMENT

What is owed?

The relevant employment law and any better employment terms decide the benefit.

02 / FUND ARRANGEMENT

Who pays it?

Check whether the employer pays directly, an approved gratuity fund pays, or a qualifying provident fund replaces it.

03 / TAX

What is received?

Apply the right exemption and tax calculation. A gross benefit is not necessarily the amount paid into the employee's bank.

A Rs 600,000 entitlement does not become Rs 75,000 just because a tax exemption is capped at Rs 75,000.

THE RULE

Which employment law applies?

There is no single gratuity formula for every employee throughout Pakistan.

SINDH

Start with coverage

The general threshold is ten workers or employees. Check worker status, exclusions and the small-industrial-establishment proviso.

KHYBER PAKHTUNKHWA

Check the proviso

The general threshold is ten workers. Specified provisions, including gratuity, have a separate initial exclusion for industrial sites with no more than twenty persons.

PUNJAB

Check the date

The 2026 Code needs commencement by Gazette notification. Do not assume that assent automatically brought it into force.

This guide uses Sindh and KP calculation examples. Other provinces, territories and special service regimes need their own assessment.



THREE EXAMPLES

What does coverage mean in practice?

A job title or the number on the payroll cannot answer every eligibility question.

KARACHI

A covered worker

Our main example assumes a qualifying worker in a covered commercial business with 50 employees. It avoids the small-industrial-site issue.

PESHAWAR

A small factory

A factory with 18 workers may meet the general ten-worker threshold. That does not establish that the gratuity provision applies; check the separate exclusion and notifications.

A MANAGER

Read the contract

A manager outside the statutory worker definition may still have contractual gratuity. Check the actual duties and agreed benefit.

Sindh's published small-industrial-site proviso has inconsistent standing-order numbering. Obtain a specific interpretation before relying on it.



THE RULE

How is gratuity calculated?

The applicable monthly wage amount × qualifying years of service.

Sindh uses one month's admissible wages. KP uses thirty days' wages, based on the last month for a fixed-rated worker.

COUNT YEARS

Count completed years and an additional period exceeding six months.

CHECK THE BASE

Use the legally correct wages, not an unsupported basic-salary assumption.

CHECK THE TERMS

A qualifying provident fund or better employment terms can change the result.



WORKED EXAMPLE

Five years and eight months

A qualifying fixed-rated Sindh worker resigns. There is no replacement fund or better benefit.

MONTHLY WAGES

Rs 100,000

QUALIFYING YEARS

6

GROSS GRATUITY

Rs 600,000

Five complete years count. The extra eight months exceed six months, so another year counts. $\text{Rs } 100,000 \times 6 = \text{Rs } 600,000$.

This is the amount owed before tax. The exemption is a separate calculation.



THE BOUNDARY MATTERS

Does exactly six months round up?

The wording is “in excess of six months”. Keep exact joining and leaving dates.

FIVE YEARS + SIX MONTHS

Rs 500,000

Exactly six months does not exceed six months. At Rs 100,000 per qualifying year, count five years.

FIVE YEARS + SEVEN MONTHS

Rs 600,000

Seven months exceed six months. At the same wage amount, count six years.

These examples assume the cited rule applies and no more favourable employment terms change the benefit.

THE RULE

Which pay amount should be used?

FIXED-RATED WORKER

Admissible wages

Establish the legal wage base. Labour-law wages may differ from basic pay or from the salary definition used for fund contributions.

PIECE-RATED WORKER

Highest relevant pay

The cited Sindh and KP provisions use the highest pay drawn during the previous twelve months. They do not say to use the twelve-month average.

The labour Acts refer to their respective payment-of-wages laws. Review the actual allowance and reimbursement components before selecting the base.



WORKED EXAMPLES

Small wage errors become large amounts

ALLOWANCES: AN ASSUMPTION

Rs 120,000 difference

Assume Rs 80,000 basic pay plus Rs 20,000 allowances are all legally admissible wages. Six years give Rs 600,000. Using basic pay alone gives Rs 480,000.

PIECE-RATED WORKER

Rs 420,000

Assume the highest relevant monthly pay in the last twelve months is Rs 105,000. Four qualifying years give Rs 105,000 $\times$ 4 = Rs 420,000.

The allowance example does not mean every allowance qualifies. Keep the legal assessment and payroll history supporting the chosen wage amount.

THE RULE

When does the payment become due?

RESIGNATION

Can qualify

The cited provisions expressly cover resignation, subject to coverage, benefit conditions and any qualifying replacement arrangement.

MISCONDUCT

Check the procedure

The normal entitlement provisions exclude misconduct termination. An allegation alone is not a completed disciplinary process.

DEATH IN SERVICE

Follow the legal route

The Acts provide for dependants and a deposit with the designated Commissioner. Do not simply pay whichever relative first requests it.

A labour-law right on resignation does not, by itself, prove that the conditions of an income-tax exemption have been met.



THE RULE

Can a provident fund replace gratuity?

A provident fund can replace gratuity only when the relevant legal conditions are met.

Under the cited Sindh and KP rules, employee participation and matching-or-higher employer contributions are part of the test.

SERVICE PERIOD

Check the years during which the qualifying fund existed.

MINIMUM BENEFIT

The provident-fund amount paid must meet the statutory gratuity benchmark.

SEPARATE TAX RULES

Provident-fund recognition is different from gratuity-fund approval.



WORKED EXAMPLE

A provident fund is Rs 30,000 short

Assume the Sindh or KP replacement conditions otherwise apply for the same service period.

GRATUITY BENCHMARK

Rs 600,000

FUND AMOUNT PAYABLE

Rs 570,000

SHORTFALL

Rs 30,000

The fund payment falls below the required benchmark. Resolve the shortfall under the applicable law and scheme; the existence of a PF account does not settle the question.

If the fund covered only the final three years of eight years' service, assess the earlier five years separately.

THE RULE

Punjab: publication is not commencement

The Labour Code 2026 comes into force on the date specified by a separate Gazette notification.

The Code was published following assent on 10 February 2026. A commencement notification was not verified for this review.

BEFORE APPLYING IT

Confirm the operative law for the settlement date.

EARLIER FRAMEWORK

The 1968 Ordinance has its own coverage and provident-fund provisions.

ACCRUED RIGHTS

The Code contains repeal, savings and specific protection of earlier gratuity rights.

THE RULE

What does Punjab's new Code provide?

Subject to commencement and coverage. "M" below means the notified monthly minimum wage.

AVERAGE PAY: UP TO $5 \times M$

Uncapped category

Termination by either party other than for gross misconduct. Section 159 generally provides thirty days' remuneration per qualifying year.

ABOVE $5 \times M$, UP TO $10 \times M$

12-month cap

Section 160 specifies redundancy or retrenchment only, with a maximum of twelve months' remuneration.

ABOVE $10 \times M$

6-month cap

Section 160 specifies redundancy or retrenchment only, with a maximum of six months' remuneration.

Section 159 excludes establishments with fewer than twenty workers and requires a year of continuous service. Earlier accrued rights need separate protection.



READ THE CONDITIONS FIRST

How could the Punjab rules change a result?

ILLUSTRATIVE CAP

A 12-month limit

If the second pay category and a qualifying redundancy apply, an uncapped fifteen-month result is subject to the twelve-month cap. Check preserved rights and better terms first.

PROVIDENT-FUND COMPARISON

Whose money counts?

Section 161 compares the employer's PF contribution with gratuity. Do not automatically count the employee's own contributions as the employer's replacement funding.

These explain the enacted Code, not a claim that it commenced on its assent date. Do not change a Punjab settlement without checking the notification.



THE RULE

Where does income tax start?

Gratuity is included in salary. A specific exemption must be identified.

The employee's exemption, the approved trust's income and the employer's deduction are three separate tax questions.

EMPLOYEE

How much of the payment is exempt?

TRUST

Is income earned by the approved fund exempt?

EMPLOYER

How much of the contribution is deductible?



QUALIFYING RETIREMENT PAYMENT

Three routes. The same Rs 600,000.

Assume the payment and recipient meet all conditions of the relevant clause 13 route.

COMMISSIONER-APPROVED FUND

Rs 0 taxable

Clause 13(ii): the Rs 600,000 qualifying payment can be exempt. The Rs 300,000 and Rs 75,000 limits do not apply to this route.

BOARD-APPROVED SCHEME

Rs 300,000 taxable

Clause 13(iii): a qualifying scheme applies to all the employer's employees. The exemption cap is Rs 300,000, leaving Rs 300,000 taxable.

ELIGIBLE FALLBACK ROUTE

Rs 525,000 taxable

Clause 13(iv): the lower of half the payment or Rs 75,000 is exempt. Rs 600,000 less Rs 75,000 leaves Rs 525,000 taxable.

The opening clause refers to retirement or heirs on death. Check the actual payment event. A resignation entitlement alone is not an exemption approval.



A SMALLER PAYMENT

How does the fallback exemption work?

GRATUITY OF Rs 100,000

Rs 50,000 exempt

Half of Rs 100,000 is Rs 50,000. That is lower than Rs 75,000, so the exemption is Rs 50,000. The other Rs 50,000 is taxable.

CHECK THE EXCLUSIONS

Not available to everyone

Clause 13(iv) excludes specified cases: payment outside Pakistan; a director who is not a regular employee; a non-resident individual; and prior gratuity from the same or another employer.

Government and specified statutory-body employees have a separate service-rule route under clause 13(i). Do not apply that route to an ordinary private company.



CONDITIONAL TAX EXAMPLE

Taxable gratuity is not the tax bill

Assume the payment qualifies for the section 12(6) election and the employee validly makes it.

TAXABLE AMOUNT

Rs 525,000

PRIOR 3-YEAR RATE

10%

TAX ON THAT AMOUNT

Rs 52,500

Prior three-year taxable income: Rs 6,000,000. Tax paid or payable on it: Rs 600,000. $\text{Rs } 600,000 \div \text{Rs } 6,000,000$ gives 10%.

On a Rs 600,000 gross payment, with no other deductions: Rs 547,500 remains. This is not a universal 10% rate. Check classification, the election deadline and withholding.

THE RULE

What makes a gratuity fund “approved”?

A written approval under Part III of the Sixth Schedule, effective for the relevant period.

The Commissioner grants approval. Creating a trust, naming a bank account or submitting an application is not the approval itself.

TRUST

Irrevocable trust for a Pakistan trade or undertaking.

EMPLOYEES

At least 90% of employees employed in Pakistan.

PURPOSE & PAYMENT

Permitted benefits on retirement, incapacity, qualifying termination or death. Employer contributes; benefits payable only in Pakistan.



FROM APPROVAL TO PAYMENT

What should the employer actually keep?

ESTABLISHMENT

The legal documents

Keep the executed trust deed, governing rules, application documents and relevant accounts.

APPROVAL

The actual order

Keep the signed approval, effective date and conditions. An application date is not automatically the approval's effective date.

PAYMENT

The evidence

Match the recipient and payment event to the rules. Keep the calculation, payment record and exemption assessment.

Example: if the fund's rules change, notify the Commissioner promptly. Failure can cause approval to be deemed withdrawn from the change date unless the Commissioner orders otherwise.

THE RULE

How are fund contributions limited?

ORDINARY CONTRIBUTION

Use the approved basis

Rule 117 sets a reasonable definite basis approved by the Commissioner, with an ordinary annual ceiling tied to the employee's salary for the last month of the financial year.

EXAMPLE

Rs 80,000 ceiling

If that defined monthly salary is Rs 80,000, the stated ordinary annual ceiling is Rs 80,000 for the employee. The approved basis may require less. Special deficit funding needs prior approval.

Fund salary includes qualifying dearness allowance but excludes other allowances and perquisites under the cited definition. It may differ from labour-law gratuity wages.

THE RULE

Is the full contribution tax-deductible?

Section 21(ea) disallows the amount exceeding 50% of a contribution to an approved gratuity fund.

Approval alone does not make the employer's whole contribution deductible. Other contribution and withholding conditions also apply.

APPROVED FUND

Apply the 50% restriction and the other deduction tests.

UNAPPROVED FUND

Section 21(e) addresses contributions to an unapproved fund.

PAYMENTS TO EMPLOYEES

Ensure effective withholding arrangements for taxable fund payments.



EMPLOYER TAX EXAMPLE

Rs 1 million paid does not mean Rs 1 million deducted

Assume the contribution meets the other applicable conditions.

APPROVED-FUND PAYMENT

Rs 1,000,000

DISALLOWED UNDER 21(ea)

Rs 500,000

POTENTIALLY DEDUCTIBLE

Rs 500,000

The employer's deduction is separate from the employee exemption. A qualifying fund payment to the employee can be exempt even though part of the employer's contribution is disallowed.

Income earned by trustees on behalf of an approved gratuity fund has a separate exemption in clause 57(3)(ii). Do not confuse these three tax treatments.



KEEP THREE RECORDS

What changes in the accounts?

PROVISION

An obligation recorded

A provision records an accounting obligation. It does not prove that money has been contributed or that a tax deduction is available.

CONTRIBUTION

Cash goes to the fund

Match contributions to the approved basis, bank evidence and employer tax reconciliation.

SETTLEMENT

The employee is paid

Match the gross benefit, exemption, withholding, net payment and any reduction in the recorded obligation.

Example: a Rs 1 million year-end provision is not evidence of a Rs 1 million fund contribution. The employer's reporting framework determines accounting measurement.



A SEPARATE PROVISION

What about seasonal workers in Sindh?

2021 AMENDMENT

Read Standing Order 20-A

The amendment removed the earlier seasonal proviso in SO 16(6) and introduced a separate end-of-season payment. Its explanation uses a 75% attendance test, with specified interruptions protected.

Rs 50,000 MONTHLY WAGES

An extra Rs 50,000

For a worker who meets the conditions, the additional seasonal payment is one month's wages. It is paid in addition to the wages due for the immediately preceding month.

Do not relabel ordinary last-month wages as the additional benefit or apply the regular annual-service examples without checking this special rule.



FAQ

Questions employees often ask

"DO I NEED FIVE YEARS?"

Do not assume so

The cited Sindh and KP gratuity provisions do not state a general five-year waiting period. Check the actual coverage and service rule.

"I RESIGNED. DO I LOSE IT?"

Not automatically

The cited provisions address resignation. A qualifying PF replacement or other legal conditions may still affect the entitlement.

"IS Rs 75,000 THE MOST I GET?"

No

It is a cap in one tax-exemption route. It does not cap a Rs 600,000 employment entitlement.



FAQ

Questions employers often ask

"WE HAVE A PF. ARE WE DONE?"

Check the comparison

Review the contributions, service period and statutory benefit benchmark. A PF label is not enough.

"CAN WE RENAME THE PAYMENT?"

The substance matters

Calling notice pay or leave encashment "gratuity" does not establish an exemption. Classify each final-settlement item.

"IS FUND APPROVAL PERMANENT?"

Conditions continue

Maintain the approved rules, report changes and retain the records. Approval can be withdrawn or deemed withdrawn in specified cases.



A PRACTICAL WORKFLOW

What should payroll do before paying?

- 1 Confirm coverage**

Location, establishment, worker status, dates and better employment terms.
- 2 Calculate the benefit**

Verify service and wages; review any qualifying PF replacement.
- 3 Check the tax route**

Approval order, effective date, payment event and exemption conditions.
- 4 Review and reconcile**

Gross benefit, taxable portion, tax, net payment, accounts and fund records.

The client or authorised payer releases the funds. Expert Arm can support the calculations, review and reporting.



GLOSSARY

Terms used in this guide

TERM	MEANING
Gratuity	A lump-sum benefit due under the applicable employment law or terms.
Gross entitlement	The benefit owed before lawful tax or other deductions.
Qualifying service	The service period counted under the relevant rules.
Admissible wages	The wage amount legally used in the gratuity calculation.
Provident fund	An employee savings arrangement with contributions under its rules.
Approved gratuity fund	A fund approved by the Commissioner under Part III of the Sixth Schedule.

Definitions summarise the terms as used in this guide; the statutory wording remains controlling.



GLOSSARY

Tax and approval terms

TERM	MEANING
Board-approved scheme	A separate approval route under clause 13(iii), with its own exemption cap.
Taxable gratuity	The portion entering the tax calculation, not the tax bill.
Withholding	Tax deducted by the payer for payment to the tax authority.
Deductible contribution	An amount allowed when calculating the employer’s taxable income.
Trustee	A person responsible for administering trust assets under the rules.
Commencement	When legislation comes into force; it may differ from its publication date.



EXPERT ARM

A sound calculation starts with the right law

PAYROLL OUTSOURCING

Calculate & review

Service records, wage bases, final settlements and reporting.

[View service](#)

ACCOUNTS OUTSOURCING

Reconcile the records

Provisions, contributions, payments and supporting schedules.

[View service](#)

INTERNAL AUDIT

Strengthen the controls

Approvals, evidence, consistency and independent review.

[View service](#)

Legal interpretations, tax positions and fund approvals require the relevant Pakistani adviser or authority. This guide is general information, not an individual determination.



REFERENCES & DOWNLOADS

Official employment-law sources

Provincial Assembly of Sindh

Standing Orders Act 2015 (Act XI of 2016)

Coverage: pp. 1–4. Gratuity: SO 16(6)–(9), p. 13.

Provincial Assembly of Sindh

Standing Orders Amendment Act 2021

Seasonal-worker amendment: s. 3(v)–(vi), PDF p. 2.

Government of KP — KP Code

Standing Orders Act 2013

Coverage: PDF pp. 2–3. Gratuity: SO 17(6)–(9), PDF pp. 16–17.

Government of Punjab — Punjab Laws

1968 Standing Orders Ordinance

Coverage: pp. 227–228 (PDF 3–4). Gratuity: p. 237 (PDF 13).

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Punjab Labour Code 2026

Commencement: p. 14. Benefits: pp. 81–82. Repeal: pp. 170–171.



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Official tax sources

Federal Board of Revenue

Income Tax Ordinance 2001 — updated 30 June 2026

Salary: pp. 49–51. Deductions: pp. 65–67. Withholding: pp. 314–315. Employee exemption: pp. 573–574. Fund income: p. 582. Fund rules: pp. 741, 746–748.

Federal Board of Revenue

Income Tax Rules 2002 — updated 24 November 2023

Rules 115–120: pp. 282–284 (PDF 294–296). Latest consolidated Rules PDF listed by FBR at review; check later individual SROs for an actual transaction.

Use the exact PDF editions named here when checking page references. Government documents are the legal sources; the examples are explanatory.

Author

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